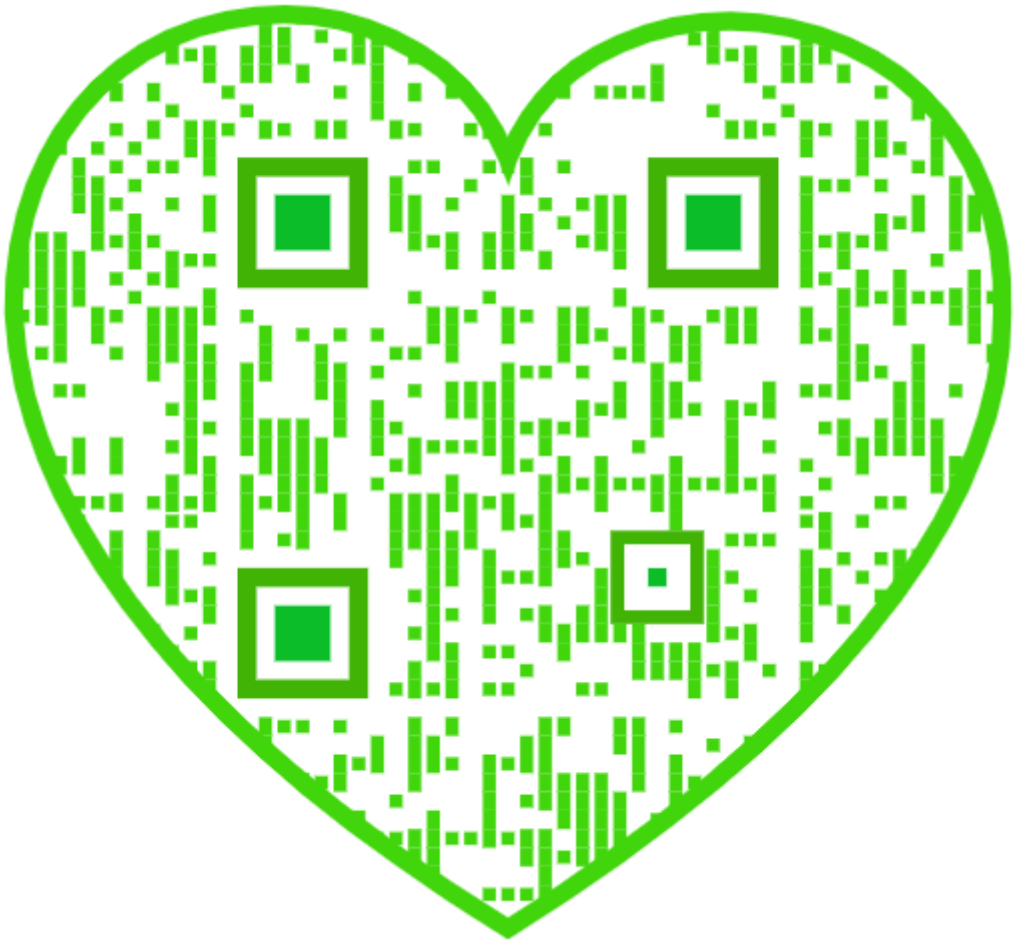
MODERN BANKING; COMMERCIAL AND CREDIT PAPER



Modern Banking; Commercial and Credit Paper

(*IN FIVE PARTS*)

By

FREDERICK SILVER

A New, Authoritative, and Standard Reference Work in Five Parts Covering the Entire Field Relative to Modern Banking and Credit Practice; Bank Acceptances; Trade Acceptances; Commercial Banking and Credits; Banking Under the Federal Reserve; The Federal Reserve System with Amendments, Rulings, Regulations, Opinions of Counsel on the Subjects of Bank and Trade Acceptances and Commercial Banking to 1920; American and Foreign Discount Markets; American and Foreign Credit Systems; etc., etc. Complete with Forms, Agreements, Records on the Subject of Acceptances, Commercial Banking and Credits; Dollar Credits for Financing Foreign Trade; Laws Relating to Negotiable Instruments, their Taxation; Digest of Bill of Lading Laws; U. S. Warehouse Laws and their Relation to Acceptances and Commercial Banking; Investments; Foreign Financing; etc., etc.

The Commercial and Financial Institute of America
New York City.

To

A.

IN MEASURELESS APPRECIATION
OF A SPIRIT OF ACCOMPLISHMENT
WHICH COMES FROM CONTACT
WITH A CLEAR AND HELPFUL MIND,
THIS WORK IS AFFECTIONATELY
DEDICATED

FEB. 23, 1920

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THE COMMERCIAL AND FINANCIAL INSTITUTE OF AMERICA
NEW YORK

PLAN OF BOOK

Introductory

The plan in Part I of the book is to review, first, the simple procedure in banking and credits; their development; their relation to the subject of money, and to give an analysis of the meaning and utility of credit. A treatise on the banking system of the United States before the adoption of the Federal Reserve System is given for the purpose of drawing a comparison with the Federal Reserve System following. The principles and operation of the Federal Reserve are briefly but interestingly outlined in their particular relation to commercial banking practice and to the rapidly growing American discount market.

The banking and credit systems of England, France and Germany should be found very helpful and of interest to the study and to the application of the acceptance method in commercial banking and credit practice.

Part II treats of the trade and bank acceptance and their importance to modern day commerce and finance. Therein are reviewed many important topics comparatively new to American banking and business. The history of the acceptance, its re-introduction into the system of American credit and finance, its practical utility in the conduct of American business, its advantages to the buyer, seller, retailer, banker, investor and to the national interest, the American discount market, discount corporations, expressions and opinions by specialists on the acceptance method, and general conclusions as to the need for co-operation by all interests concerned, are the main features of Part the Second. The operation of bank acceptances, dollar credits, investments and other topics, as for instance, "Procedure in the Use of Acceptances, Plans, Publicity, etc.," should prove of interest.

By far the most important improvement in commercial banking practice has been the equal development of standardized commercial paper, principally the trade and bank acceptance as important elements of the American credit system. The Federal Reserve Board, through its few years of operation, has broadened the scope of banking activity by the admission and standardization of commercial paper. For this reason, there is given practically all there is to the subject of Acceptances, and Commercial Banking Practice under the Federal Reserve. The Amendments to the Federal Reserve Act, the Rulings and Regulations of the Board, Opinions of Counsel, General Statutory Provisions, to 1920, covering Bank and Trade Acceptances, Discounts and Re-discounts, Advances, Open Market Transactions and Investments are of great importance as a reference work.

Part IV is an embodiment of the most approved forms and agreements on bank and trade acceptances and commercial banking practice. Each form is explained to the best detail, and having the

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stamp of approval of the leading commercial and financial bodies of the country, is available for use by commercial and banking establishments.

Part V contains a collection of laws relating to acceptances and commercial banking. The Negotiable Instruments Law should be of particular importance as a legal reference on the subject. The United States Warehouse Act, with headings, is given, as an aid to the subject of bank and trade acceptances. A Digest of the Federal Bill of Lading Act is also given for purposes of reference. The chapter on the Taxation of Negotiable Instruments is most complete as an analysis in the fullest detail. It will serve to clear up many doubtful questions that have arisen or may arise in connection with the taxation under the present Federal Revenue Laws of negotiable commercial paper. Lastly, there is reviewed the Edge Act for Foreign Financing making possible a more extensive credit and banking programme abroad. It is hoped that this important amendment to the Federal Reserve Act will prove of great benefit to the Nation and to the further development and extension of its foreign commerce.

In presenting the subjects of "Modern Banking and Credit Practice," "Bank and Trade Acceptances," and "Commercial Banking and Credits,'" under the present banking system, the author feels that it will meet the needs of the practical business man and the banker of the country by giving additional light upon these important subjects and by outlining their usefulness and importance to the manufacturer, producer, the merchants, both buyer and seller, the exporter, the importer, the banker, the investor and the public in general.

In preparing this work, the author has not had the advantages of others writing on different topics of banking and credits, the fields of which are much more developed, and upon which a good deal has already been written. The available matter on Acceptances and the newer banking and credit subjects is very limited even to date, and, with the exception of a few phamplets issued by the larger banks, the discussions contained in which are very helpful to a study of the relative subjects nothing of note has been availed of. In the majority of cases, research has been found necessary by a study of actual methods as at present practiced.

It is hoped that this work will prove a useful addition to the bank and commercial library, as well as to the banker, the business man and student of commercial and financial methods.

New York, 1920. FREDERICK SILVER.

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DIGEST OF THE FEDERAL BILL OF LADING ACT

With a Preface as to its Importance to Commerce and Finance

THE UNITED STATES WAREHOUSE ACT

Its Importance to the Acceptance and Commercial Banking

PART I

MONEY, BANKING AND CREDITS

1. Money, Banking and Credits.
2. Banking in the United States before the Adoption of the Federal Reserve System.
3. Banking in the United States under the Federal Reserve System; its Principles and Operation.
4. Banking and Credits in Europe, England, France and Germany.

CHAPTER I

Money, Banking and Credits

Commerce in the primitive ages was carried on by the exchange of goods or commodities, otherwise known as barter, and without the use of money or credit. Since the time men first came into active contact with each other, they endeavored to obtain their needs by whatever means appeared to them best, and as they were always in need of some particular article, class of goods or merchandise, which another possessed, it became a practice for them to give up an article which was less desirable in exchange for one which they could use to better advantage.

But as men and arts increased, a mere barter of commodities became inconvenient and insufficient in abundance of instances. A better medium of exchange or some standard of computation—of value—capable of being handled much more conveniently than the bulky wagonload of wheat or drove of oxen, became necessary.

In still an early period in the economic history of man, there was established some medium of exchange in the form of goods. Skins of animals at one time constituted a medium of exchange. Wheat, corn and other cereals by the bushel or specific load constituted also an exchange value. Tobacco, wool and other staple commodities also formed a medium of exchange. A better substitute was found in the baser metals, such as iron, bronze, copper, etc., which being put into certain shapes and forms, also served as mediums of exchange. The Romans and the Grecians had coins of bronze, and later of gold. Other races had iron money. The Indians, at the time of the discovery of America were found to use wampum shells as money.

With the progress of man, the general utility of precious metals as a form of money was recognized, and the employment of silver and gold as common measures of value was found to be much more practical than the preceding systems of exchange. By these improved means, one might then, instead of waiting for his crops to mature, or

for his sheep or horse to become full grown, employ this gold or silver as a means of acquiring what was most desired.

But, in time, people came to feel the inconvenience of carrying with them a supply of coin and bullion, and became satisfied, in commercial transactions, to accept a promise on the part of the purchaser to pay the amount due at a certain date. This was the foundation of our modern credit system. The people, thereafter, feeling the unsafety attendant upon their keeping such coin and bullion, in the form of gold, silver and other precious metals always in their possession, or hoarded away and unproductive in their homes, entrusted these funds to a class of goldsmiths and custodians of valuables, who were in a much better position to care for them. A fee in the form of a commission was generally paid in consideration of the custodian's services.

Later, the goldsmiths and custodians of valuables, principally the Florentine in Italy, and the Lombardi in England, were quick to realize the opportunity existing in lending out the money deposited with them to others for a consideration in the form of "interest," which the borrowers paid them for the use of this money. The development of this system of lending was coincident with the rise of modern banking.

The next step was the development of a credit system, whereby present values were given in exchange for promises of future performance. Thus, A sells to B a certain quantity of merchandise, and instead of acquiring cash in the sale, which would take it without the bounds of a credit transaction, he takes as a substitution for immediate payment a promise on the part of B to pay the value thereof at a future time.

CREDT; DEFINITION OF CREDIT

Credit may be broadly defined as the power to get goods in exchange for a promise or contract to deliver an equivalent at some future time. In other words, it is a promise to pay money in the future in exchange for some consideration received in the present. Thus, a man is said to have good credit if he has the reputation among his business friends of paying his debts promptly when due. A firm is said to obtain a line of credit with another business house or from a bank, if its financial and moral standing is such as would support the "credit," with assurances that it will be met at the proper time.

Confidence and Futurity Both Elements of Credit

Credit is based upon confidence. Credit is also based upon futurity of payment. There is some difference of opinion as to whether confidence or futurity is the essential thing in credit and as to whether credit is based upon money or upon goods. Futurity may be said to be the distinctive factor in credit, while confidence lies at the basis of the granting of credit. The time element in credit is likewise very important. In every type of credit transaction, as call loans and mortgage loans, confidence rests more on the security or property pledged than upon the borrower's personal integrity, though confidence is present in some form or other in all transactions involving the granting of credit. Credit is usually expressed in terms of money, though it is extended by means of goods, and is completed by the payment of money.

Functions of Credit

The most important service of credit is to facilitate the transfer of capital and thus to promote the production of wealth. Credit is not in itself either capital or wealth. It is a means to both. Wealth consists of economic things and capital consists of economic goods used in the production of wealth.

Credit has been characterized as the wheels of commerce. It is more than this. It is the foundation of business. It is, as Daniel Webster said, "the vital air of the system of modern commerce. It has done more—a thousand times more—to enrich nations than all the mines of all the world. It has excited labor, stimulated manufactures, pushed commerce over every sea, and brought every nation, every kingdom and every small tribe among the races of men to be known to all the rest. It has raised armies, equipped navies and triumphed over the gross power of mere numbers. It has established national superiority on the foundation of intelligence, wealth and well directed industry.

"Credit is to money what money is to articles of merchandise. As hard money represents property, so credit represents hard money, and is capable of supplying the place of money so completely that there are writers of distinction who insist that no hard money is necessary for the interests of commerce.

"I am not of that opinion. I do not think that any Government can maintain an exclusive paper system without running to excess,

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and thereby causing a depreciation. I hold the immediate convertibility of bank notes into specie to be an indispensable security for their retaining their value, but consistently with this security and indeed founded upon it, credit becomes the great agent of exchange. It increases consumption by anticipating products and supplies present wants out of future needs. As it circulates commodities without the actual use of gold and silver, it not only saves much by doing away with the constant transportation of precious metals from place to place, but also accomplishes exchanges with a degree of dispatch and punctuality not otherwise to be obtained. All bills of exchange, all notes running upon time, as well as the paper circulation of the banks follow to the system of commercial credit. They are parts to one great whole. We should protect this system with increasing watchfulness, taking care on the one hand to give it full and fair play, and on the other to guard it against dangerous excess."

It has been estimated by authorities that ninety per cent. of the nation's business is conducted on credit. To estimate its importance to the commercial world, let us assume that no such thing as credit exists. We should then be compelled to use some other medium of exchange to transact the same volume of business as is carried on at present. Every purchase would require an immediate payment in the next best substitute, which for the moment, let us say is gold. This would require in the conduct of modern business many times more of the precious metal than the available supply. The value of credit can therefore be readily estimated.

THE VARIOUS KINDS OF CREDIT

The divisions of credit have been classified as follows: Public credit; capital credit; mercantile credit; individual or personal credit; and banking credit; which last named includes commercial credit.

By "public credit" is meant chiefly the borrowing operations of governments, whether national, state or local, through the issue of interest bearing obligations or securities. By the issuance of such securities, the government receives a form of credit called "public credit," because it is used for public purposes. The consideration upon which it receives this credit is by its giving to lenders a promise of future performance, that is, of future payment of its obligations in the form of bonds or certificates evidencing indebtedness.

By "capital credit," or "industrial credit," is meant the credit used by corporations in procuring the necessary capital requirements for their business operations. The bondholders extend funds to the corporation in exchange for the corporation's promise to pay them at a future date the equivalent value of the bonds, with interest.

Capital investments, as for instance, by a proprietor of a business, or by a co-partnership are not "capital credit," because they work for themselves alone, and the profits of the business, whatever they may be, go to the owners alone. This is really no form of credit. It is rather a "capital investment."

"Mercantile credit" is used by producers, wholesalers, retailers, commission merchants, etc., in connection with the manufacture and sale of goods from producer to ultimate consumer. A manufacturer would buy a quantity of raw materials to be made into finished products. To obtain this raw material, he would agree to pay the producer of the raw material only after he has sold the product. In this way there arises a form of credit known as "mercantile credit," or a time obligation, that is, a promise of future payment. An indirect means of mercantile credit would be a loan from the bank by the manufacturer whereby the credit is extended by the bank instead of by the producer.

The term "personal" or "individual credit" designates that form of credit availed of by individuals, rather than by public or private corporations. It is the means by which an individual may secure goods for consumption purposes, without an immediate payment of cash. This form of credit appears in the time payment plans of the laborer and the salaried man, who might pay weekly or monthly his grocery bill, meat bill, gas or electric light bill. Equivalent terms under this heading are "consumption credit" and "retail credit," because primarily used in retail transactions. Personal credit generally does not require a security of any kind other than an implied promise or written promise to pay in the future.

The most important form of credit is "banking" or "commercial credit." Banks in this connection furnish funds to borrowers of every description, and it is to the banks that one in need of credit naturally turns. "Bank" or "commercial credit" is extended by means of the bank's own capital, and also in part from the funds which have been left with the bank by depositors in general, and what is most im-

portant of all, through the use of the bank's own credit. A bank uses its own credit in much the same way as does an individual.

The elements of credit are a reputation for business honesty and ability, some kind of security, in the form of accommodations that enter into trade, or paper having a value, or tangible property. Borrowers under this form of credit use their good name and property as a means of securing funds for immediate use. A bank, likewise if it possesses the confidence of the community, is able to extend its business by means of its credit. This is evidenced by the fact that the community entrusts its funds to the bank for safekeeping or general use, as the case may be.

But a more important way in which commercial banks use their credit is illustrated by the following: A bank knows from experience that to every cash dollar required in the operation of its business, ten times that amount in the form of credit, or transactions not requiring the use of actual money, are necessary. If, therefore, a bank has one million dollars in cash on hand, it is able, by means of its credit, to do a business equal to many times the amount of cash it has. This is accomplished through borrowing on its credit.

BANKING

In our system of banking, there are at least three types of institutions distinguishable, the savings bank, the investment bank and the commercial bank.

The organization of savings banks is along entirely different lines from either the investment banks or the commercial banks, and is easily distinguishable from them. They usually encourage savings on the part of the people, endeavor to collect such savings otherwise hoarded by the populace, and, after acquiring them in sufficiently large numbers and amounts, use them in loans on such security as real estate, and by investments in Government bonds, high grade railroad bonds, and such other securities as are designated legal investments for trust funds by the State wherein the savings bank is located. In this way they release such funds for productive purposes. Legislative enactments make the operations of savings banks of a most conservative nature, and every effort is made, on the part of the public, through its legislature, to protect the depositors as well as to maintain a system of savings of a quasi-public nature. The funds of savings banks

are usually tied up for a long period of time, and the security on which loans are made by them is often of a character that cannot be marketable to the full advantage, except at an opportune time.

The Investment Banker

The investment banker may be considered as a middleman pure and simple. To him are presented propositions of various natures pertaining to the financing of industries, commercial enterprises, railroads, etc. The investment bankers exercising the most influence are generally those which have acquired, through a long period of business operations a clientele, through which distribution of securities representing new enterprises is made possible. Apparently, it may be seen that the investment banker is limited in his operations. With the exception of the very large ones, of which there are few in number, the services of the investment banker are to-day not so widely available as in the past. This is due mainly to the fact that through successive legislation, the State and National banks have acquired powers permitting them to engage in operations similar to those by which the investment banker is characterized. However, in new enterprises, having a speculative character, or basis, upon an undeveloped field, the aid of the investment banker is most sought for and utilized. His functions may be said mainly to consist of mobilizing the investment funds of the nation and to assist in the apportionment of those funds to productive uses.

Commercial Banks

Of the thirty thousand or more banks in the United States, twenty-eight thousand or so are known as commercial banks, and it may be said that it is upon the success or failure of their operations that the prosperity of the nation is closely bound up. Commercial banks may be considered as credit institutions and as the country's credit managers. Their purpose consists in mobilizing the country's reserves, and so using them as to make them most productive and of most benefit to the country. Unlike the operations of savings banks, with their secured character and unfluctuating conditions coincident with a savings and conservative population, the commercial banks cannot and neither are they at law permitted to tie up their funds in long time

investments. The nature of their business and the very basis of their existence is in rendering the maximum of service to the business community. A depositor may have entrusted only yesterday to a bank the keeping of a sum of one hundred thousand dollars, not knowing at which time he will find it necessary to use the funds. A day or so later there may present itself an opportunity for him to take advantage of, and he may thus be required to use such funds to materialize his purpose. This may necessitate the withdrawal of a large part of his deposit amount, which may be the case with a thousand and one depositors of the same bank. It is, therefore, apparent that even in its regular course of business, the operations of the commercial bank are far different from the investment bank. It must be enabled at any time to convert its assets, in whatever form, into ready funds. Liquidity of assets is as important in a commercial bank's operations as security of assets.

THE FUNCTIONS OF COMMERCIAL CREDIT

The business of commercial banks is said to be to "lend" or "discount" and to hold deposits. A third function may be combined with the above two, that is, the issuance of bank notes or the bank's own promises to pay, for use in general circulation, as a substitute for money.

Borrowers procure loans from banks for the purpose of providing themselves with the means either of making some purchase or of paying some debts. They seek, therefore, to obtain not necessarily money, but a certain amount of purchasing power in available form or whatever may be the usual mediums of payment—measured in terms of money.

If we suppose the prospective borrower to be a merchant, buying and selling goods on credit, in the regular course of his business, he is likely at any given time to have in his hands a greater or lesser number of notes not yet due signed by the persons to whom he has previously made sales. It is in the form of a loan, made upon the security of one or more of these notes giving him immediate command of the amount which will become due upon them in the future, that he is likely to procure what he needs from the bank. This loan may take the form of what is termed a discount, in which case, in exchange for the note "discounted," the borrower is entitled to receive

from the bank the amount promised in the note, less the interest on that amount, computed at an agreed rate, for the term which the note has still to run. The discounted note becomes the property of the bank, to which the promisor is henceforward bound to make payment at maturity, and this payment, when made, obviously restores to the bank the amount advanced by it in exchange for the note, together with interest, which was the inducement for making the exchange.

The above operation is generally spoken of as a loan by the bank to a borrower. But, however, it is more than a mere loan. When the note was given to the bank, it bore evidence that its holder owned the right to receive at a fixed date, a certain sum of money, and this right the so-called borrower has ceded to the bank. We might consider this as a sale to the bank of a right to receive money in the future, in the same manner as a sale of a bale of silk. Immediately upon its transfer to the bank for a consideration, the note takes its place among the investments or securities of the bank, though it still retains its classification as a loan or discount.

We may now consider what it is that the bank gives in exchange for the right to demand and receive money at a future time, acquired by it under these circumstances. The proceeds of the discounted note or its nominal amount, less the interest for the time for which it is to run, are, in the first instance placed to the credit of the merchant, to be drawn out by him at once, or at different times as convenience or necessity may dictate. The bank, in giving credit for the proceeds, gives really a right to call upon it, at pleasure, for that sum of money. This right may not be exercised at once, but may be postponed as regards the whole or a part of the amount until a much later date. The process is therefore an exchange of rights, that ceded by the merchant to the bank in exchange for the bank's right to demand or to draw against it an equivalent sum.

A deposit, however, may owe its origin to a different operation from that above cited. It might be that the merchant, having cash in hand, prefers not to hold it in his possession until required for use by him at a future date, but prefers to deposit it with the bank with which he usually transacts his business, until a need for this money arises. Here, too, with the passing of the money to the bank, the "depositor" receives in exchange the right to demand and receive at pleasure not that which he paid in, but an equivalent amount. This is also an exchange of rights, the one given up by the depositor being the right

to immediate use of the money by the bank, in exchange for the bank's right given to the depositor to demand a sum of money from it at any time.

The following is also an illustration of an exchange of rights, as for example, where a bank, for the convenience of its customer or depositor undertakes to collect a note due to him by some third party, in which case the amount paid to the bank, in money, by the promisor, is passed to the credit of the promisee as a deposit. In this case, the bank has received money for the account of the depositor, and has given to him in exchange for this money a right to draw at pleasure for the amount or any part thereof, the property in the money actually paid having passed absolutely to the bank in exchange for the right to draw.

The exchange of rights is also illustrated where a bank buys a bill of exchange from a merchant, or when it sells its own bill of exchange drawn on its correspondent, both being in effect exchanges of money against a right or of a right against money.

We next come to a consideration of a third form of banking operation, which exists in the issuance of bank notes. This is in effect only another form of liability, which differs in appearance, though not in substance, from the liability for deposits. A bank note is defined as a duly certified promise on the part of the bank to pay on demand, a certain sum of money, and is adapted for circulation as a convenient substitute for the money which it promises. It is issued by the bank and can be issued only to such persons as are willing to receive the engagement of the bank in this form, instead of receiving money or instead of being credited with a deposit. Thus, the so-called borrower, who in the first instance has been credited with a deposit and to whom the bank is therefore to this extent liable, may prefer to draw the amount in notes of the bank and to use them in making his payments. In this case also, as well as in the preceding ones, the bank does not give up actual money, for if the depositor pays in money, and receives notes, or receive notes in satisfaction of a demand of any kind against the bank, he foregoes the use of the money itself and consents to receive in its stead a promise to pay on demand, the evidence of which promise is in the form of notes.

In all cases cited, therefore, an exchange of rights is the result. It is an acceptance of a present value by the bank for an exchange of a right to demand money at a future date. While this does not exclude

the possibility of an exchange of rights of present values, still the majority of transactions passing through a bank's operations consist of the exchange of such rights which are in substance of present value to the bank and of future value to those with which it deals, and sometimes vice versa. The first case is best illustrated in depository accounts, while the reverse is true in the process of discounting.

The Services and Functions of a Bank

Banks are utilized most as places of security for the deposit of money. The business of banking arose from a desire on the part of merchants to obtain a place where they might with safety lodge their funds. It is common knowledge that anyone who has had the care of large sums of money, knows that it is not without great anxiety attendant upon their custody. A person in this case must either take care of his money himself or entrust it to a servant. The better way would be to entrust it to others whose honesty and ability are well known, and who are engaged especially in that class of business. The evils accompanying the keeping of one's money under one's own roof are many, which by means of banking are practically eliminated.

Banks invariably allow interest for sums of money placed in their hands as deposits. In this way, large sums of money, which otherwise remain unproductive in the hands of individuals or hoarded away, are collected into large amounts in the hands of the bankers who employ them in granting facilities to trade and commerce. Thus, banking increases the productive capital of the nation.

Of great advantage are the facilities afforded by bankers to the benefit of society, in the making of advances by the former to persons who want to borrow money. This is effected either by the discounting of bills upon personal security, or upon the joint security of the borrower, with sureties as an additional protection to the bank, and, also, upon deeds and mortgages on real estate, or real and personal property. It is thus that persons engaged in trade and commerce are enabled to augment their capital, and consequently their wealth. Production, moreover, is stimulated by the increase of money circulation which otherwise is kept away from the channels where it would best benefit trading.

Bankers transmit money from one part of the country to another, and from one country to another country. The necessity for trans-

ferring money arises very frequently on the part of merchants and traders. This can be most conveniently done by paying the money to a bank, which, in turn, arranges with a correspondent bank in or near the distant town to pay the designated party the amount specified. The risk of transferring actual money is therefore eliminated, and by means of periodical settlements between the two banks, such transfers are made comparatively inexpensive.

"Till money" is that denomination of currency which is best adapted for carrying on commercial operations in a particular place. Whenever a bank is established, the public is enabled to obtain that denomination of currency or "till money" which they need most in their business. In a town which has no bank, a person may have occasion to use small notes and have none but large ones, and at other times he may have need of large notes and not be able to obtain them. The banks have at all times a supply of notes of all denominations which depositors may require, and are always ready to exchange them for others of a different denomination. Banks, too, have a supply of silver at all times, and if it is necessary that the community be furnished with more silver, banks will obtain it. Contra, banks will receive specie in the form of a deposit or exchange for their notes should it be too abundant in any locality. This is of great convenience to the community as it eliminates the necessity of people keeping on hand too large a sum of money to meet their needs.

Of great advantage to a bank's customers is that service rendered by a bank by means of which one is able to save time and trouble otherwise necessary in the handling of actual money. Consider how much longer it will take to count up a large sum of money than it does to write out a check or a draft, and how much less trouble it is to receive a check or a draft to pay the bank, than it is to pay the sum of money in currency. The development of the check and the draft with its many available uses affords a great advantage and convenience to depositors of banks and the public in general.

Banks render a very valuable service in making collections for their customers. A merchant or tradesman who keeps a banker saves the trouble and expense of presenting promissory notes which he holds, or drafts which he may draw against a customer. He may turn these over to his banker for safekeeping and collection at maturity. He thus saves trouble and inconvenience on his part, since the custody of his bills, the anxiety about their being stolen, the danger of for-

getting them until they are overdue, thus exonerating the indorsers, as well as the trouble of sending such bills to a distant town in order to demand payment is shifted to the banker instead of remaining with the holder of the draft. The presenter of the draft has nothing more to do than to see the amount entered to his credit in his banker's books. If a bill be not paid, it is brought back to him on the day after it falls due, properly noted. Bankers will bear evidence to the fact that the bill was duly presented, and will furnish a notary to attest that the bill did not meet with honor upon presentation, assigning at the same time a reason why the draft was not paid.

Numerous other advantages are afforded by banks to the public generally, which are just as important as the services outlined above.

Another advantage of keeping a banker is that by this means one has a continual reference as to one's respectability. If a mercantile house in a distant part of the country writes to its agent to ascertain the respectability of a firm in another part of the country, the first inquiry is: "What are the banking references?" When this information is ascertained, the banker is applied to, through the proper channels, and he gives his testimony as to the respectability of his customer. When a trader gives his bill, it circulates through the hands of many individuals to whom he is personally unknown, but if the bill is made payable at a banking house, it bears on its face a reference to a party to whom the acceptor is known and who must have some knowledge of his character as a tradesman. This is of immense advantage to a man in business as it increases his credit standing.

By means of banking, people are able to preserve an authentic record of their actual expenditures. Assume that a person pays in to his banker all the money he receives in the course of a year and makes all his payments by checks. By proper entries as to the purpose for which his check has been drawn, as well as by corresponding entries of all receipts deposited, he may readily ascertain the total amount of his receipts and the various items of his expenditures. A bank account is useful also in case of dispute in payments. A check or draft upon a bank is the best form of receipt for money paid. A payment in actual money, that is, in the form of bills, specie, or other currency, does not furnish evidence of a payment in fact, while on the other hand, settlement by check or draft upon a bank furnishes a receipt at the same time as it effects a settlement.

By keeping a banker, people have a ready channel of obtaining much information that will be useful to them in their business. They will know the way in which bankers keep their accounts. They will learn many of the laws and customs relating to bills of exchange and banking. By inquiring of the banker, many valuable advices may be received from him. The banks furnish information as to the reliability of respectable parties with whom they would recommend dealings. They are also appointed executors and administrators of estates, act as guardians, engage in financing by means of bond issues, and perform various other functions.

Banking also exercises a powerful influence upon the morals of society. It tends to produce honesty and punctuality in pecuniary engagements. Bankers in their own interest always have a rigid regard to the moral character of the party with whom they deal. They inquire whether he be honest or tricky, industrious or idle, prudent or speculative, thrifty or prodigal, and they will more readily make advances to a man of moderate property and good morals than to a man of much property but inferior reputation. Therefore, it may be said that the establishment of a bank in any locality advances the pecuniary value of good moral character.

CHAPTER II

The American Banking and Credit System Before the Passage of the Federal Reserve Act

Kinds of Banking in the United States.—According to official figures there are in existence in this country some thirty thousand banks, all of which fall within either one of the following groups:

1. National banks.
2. State banks, which are either
   (a) State banks conducting a general banking business;
   (b) Trust companies;
   (c) Savings banks;
   (d) Private banks;
   (e) Investment banks;
   (f) Bill and paper brokers.

Supervision and Regulation.—Federal control is extended only to the national banks, while the State banks, trust companies, savings banks, private and investment banks, and commercial paper dealing establishments are under the direct supervision of the several State governments.

NATIONAL BANKS

Introduction of National Banking System; Purposes.—The original National Banking Act was framed in 1863, its establishment having been previously urged by various governmental officers, principally Salomon P. Chase, who believed its introduction would be of assistance to the government during the Civil War as a means of serving the following purposes:

First, it was believed that the introduction of the National Banking System would materially assist the government in marketing its war bonds. Second, that it would establish a uniform currency system for the country. Though the former purpose was never realized to the extent of original expectations, the unification of the currency

system of the country was of great importance in later banking developments.

Organization of the National Banking System Before the Adoption of the Federal Reserve.—The head of the national banking system was the Comptroller of the Currency. He would pass upon organization certificates on contemplated banks or would reject them as he saw fit. In the event of their acceptance, provided the law was complied with, a charter was issued to run for twenty years, except in cases of ultra vires acts, the commission of which would voluntarily dissolve the bank.

Capital Requirements; Shares and Dividends.—The capital requirements of such national banks were fixed by law, according to the population of the respective communities wherein the bank was sought to be established, the low limit of capital being twenty-five thousand dollars for banks in towns with a population of not exceeding three thousand; and two hundred thousand dollars capital in cities with a population of fifty thousand or more. Fifty per cent. of the authorized capital was required to be paid in before the bank was allowed to commence business, and the remaining fifty per cent. was to be paid in by installments of at least ten per cent. of the authorized capital each month, from the time of its authorization.

Shares were of the par value of one hundred dollars, and each shareholder was liable to an extent equal, and additional to, the amount of shares so held by him. National banks were further required to create a surplus fund of twenty per cent. of their authorized capital stock before the declaration of any dividends.

Management of National Banks; Powers and Limitations.—The affairs of the banks were managed by a board of directors, all of whom were required to be citizens of the United States. The board of directors were duly authorized, themselves, or through their agents or officers, subject to law, to carry on the business of banking, by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchanges, coin, and bullion; by loaning money on personal security and by obtaining, issuing and circulating notes according to the provisions of the Act. In connection with the last named purpose,

a national bank was required to deposit one-quarter of its capital stock in government bonds, which later served as a basis for bank note issues.

National banks were not permitted to contract debts in excess of their unimpaired capital. The total liabilities of any one firm, person or other legal entity could not exceed ten per cent. of the bank's capital.

Reserve Requirements.—Every national bank was required to keep, as reserve, an amount equal to from fifteen to twenty-five per cent. of its deposit liabilities, according to whether it was located in a central reserve city, such as New York, Chicago, or other; or in an outlying district.

By petition to the Comptroller of the Currency, a city with a population in excess of fifty thousand could be denominated a central reserve city.

The reserve banks, that is, those holding the reserve deposits of the smaller institutions, would again deposit these reserves with other banks with which they had business dealings, which latter might again redeposit such funds with other institutions, usually larger banks.

Note Issues.—National banks were permitted to issue notes secured by bonds of the United States Government deposited with the Comptroller of the Currency. Various regulations as to the extent of such issues of banks notes, in proportion to the bank's capital, were from time to time introduced, the maximum finally being fixed to the full amount of the capital stock of the bank. Notes were redeemable in lawful money at the United States Government Treasury, or Subtreasuries, or by the bank. As security for the redemption of national bank notes, national banks were required by law to deposit with the Comptroller of the Currency an amount equal to five per cent. of their note issues. This was done chiefly for the purpose of protecting the Government in the event of the failure of the bank.

Government Supervision.—The law required the submission of at least five reports annually, to the Comptroller of the Currency. National bank examiners made periodical examinations of the affairs of

every bank to ascertain its stability and were empowered to make special investigations if necessary.

Business Conducted by National Banks.—The principal business conducted by these national banks was that of "discounts and loans" and making collections for customers. They were purely commercial in character. Foreign exchange operations were carried on principally by the larger institutions, through means of foreign correspondents. They could not assist, generally, to any appreciable extent, in the development of our foreign commerce.

In domestic trade, on the other hand, these national banks had, by long and careful application to the business customs of their communities, succeeded in gaining the confidence of their customers to a large degree. They were satisfied with conditions as they existed and did not wish to see a new system of banking introduced which they feared might destroy those advantages which they had been so long in acquiring.

THE ORGANIZATION, MANAGEMENT AND SUPERVISION OF STATE BANKS, TRUST COMPANIES, AND SAVINGS INSTITUTIONS

Character of Business.—State banks, like national banking institutions, conducted a general commercial banking business. The trust company differed from the ordinary State bank, in that it was granted the privilege of exercising trust powers, and acted as administrator, executor and guardian. State banks, including trust companies, were supervised by a designated State officer, usually the State Superintendent of Banks.

Legislation; State Banks.—As may be expected, no unity of organization or of administration existed. As to capital and surplus, the various States had each their own requirements. Reserve requirements were common in State bank laws, ranging from fourteen to fifteen per cent. for time deposits, and from fifteen to twenty per cent. for demand deposits.

Supervision of State Banks.—The State banks were required, moreover, to furnish reports of their operations at least a few times a year,

to the proper State banking officers. Examiners were maintained to go into the affairs of banks at regular intervals, and, in special cases, if necessary. This procedure applied to State banks, trust companies, savings banks, and savings and loan societies.

Character of Foreign Business Conducted by State Banks.—Prior to the introduction of the Federal Reserve System, these State institutions, by reason of the fact that no such stringent legislation was imposed upon their entering foreign fields or engaging more widely in foreign financing, were much in advance of the national banks.

Their domestic business was of the order of the national banks, discounts, loans and collections comprising the bulk of the business dealings of these institutions. They, too, had built up a reputation within their communities and were by no means anxious to have it done away with, without assurances that the new system would bring them greater benefits.

PRIVATE BANKERS

Next in importance to State banks, trust companies and savings banks, came the private bankers. They were very numerous, exercising some influence among the alien population of their own race. Their operations were not as far reaching as those of the national and commercial State banks, but on a much smaller scale. They dealt generally in retail exchange and engaged in the sale of steamship tickets, acting as special agent for the transportation of goods between countries. However, in recent years, due to stringent legislation being placed upon their operations, the private bankers have felt the hardship of standing up against modern day systematically and progressively managed organizations, and their influence has passed away to a large degree.

THE INVESTMENT BANKER

The investment bankers, however, showed strong organization and progress. They exercised great influence in commercial banking operations. Their business extended to the private financing of industrials, public utilities, commercial firms, etc., engaging in stock and bond issues, and the distribution of same; dealing in foreign exchange,

and engaging in the sale and purchase of securities on commission, for account of their clients. They acted as fiscal agents for municipalities and firms, and performed a relatively important service. Not being under such strict legislative supervision as the State banks and national banks. They could extend their operations into almost any field, including foreign, on a much wider scale than the State or national banks. In some States, a reserve in the form of securities was required to be deposited with the various State governments for protection of depositors. They were very numerous as a class, and very powerful. Some of the larger establishments extended their operations even to the control of national and State banks by means of stock ownership.

THE COMMERCIAL PAPER DEALER AND BROKER

The other class of financial establishments directly supervised by the State was the commercial bill and paper broker, the services of which, in connection with commercial banking were of great importance. They generally took care of the commercial paper business of the larger firms and distributed it among the banks throughout the country. They rendered an important service to the banks in the checking of such paper, and being in a position which familiarized them with the firms with which they came in contact, they were able to relieve, to some extent, the work of the bank in matters concerning credit. They also bought such commercial paper for their own account, and resold it to the banks when suitable opportunity presented itself to them.

RESUME OF THE AMERICAN BANKING AND CREDIT SYSTEM AS IT EXISTED BEFORE THE INTRODUCTION OF THE FEDERAL RESERVE SYSTEM

The above briefly describes the banking organization of the United States as it existed before the adoption of the Federal Reserve System. As to its advantages, it could be said that the business was made to be paying. It was conducted with reasonable safety. It was adapted particularly to the community in which it was located, and the system of checks and clearings which it developed was indeed in advance of any of those in foreign countries.

But there was no uniformity of action or of coöperation among the banks. They acted altogether in an independent way. There was no centralized head. The credit system was far from elastic to any extent capable of keeping up with the growing manufacturing industries of the country. The nation's reserves were entirely scattered, the principle of the banks being more inclined to security than to liquidity. There was no system of mobility of such reserves. Neither was there any central head which could collect the reserves of the nation and hold them in readiness to be used to relieve financial strain which at times suddenly forced itself upon the nation. Nor did the then existing system enable the banks to use their reserve for most productive purposes.

Coöperation among the banks was lacking. They might have been bound socially by one or another organization, but not further than this. Individual banks were, in times of stress, helpless. There was no open discount market, nor standard form of commercial paper, which by its character might be discounted by the banks in times of need and so supply them with funds when necessary. There was no connection between the treasury system of the country and the banks. Government deposits were kept in various institutions which qualified for this privilege. Furthermore, there were no foreign branches of American banks, a fact which hindered our entry on a wider scale into foreign markets.

The panic of 1907 was the direct cause of much criticism of the banking system as it then existed. The National Monetary Commission was finally appointed to study the banking system of the country, and those of foreign nations, and to make recommendations for its improvement. In its report it brought out a number of defects, the most important of which are stated below.

Scattered Reserves

(1) We have no provision for the concentration of the cash reserves of the banks and for their mobilization and use wherever needed in times of trouble. Experience has shown that the scattered cash reserves of our banks are inadequate for purposes of assistance or defense at such times.

EFFECT OF STATE LAWS UPON RESERVES

(2) Antiquated federal and state laws restrict the use of bank reserves and prohibit the lending power of banks at times when, in the presence of unusual demands, reserves should be freely used and crdit liberally extended to all deserving customers.

IMMOBILITY OF RESERVES

(3) Our banks also lack adequate means available for use at any time to replenish their reserves or increase their loaning powers when necessary to meet normal or unusual demands.

BANK NOTE ONLY MEANS OF CREDIT EXPANSION AND CONTRACTION

(4) Of our various forms of currency the bank note issue is the only one which we might expect to respond to the changing needs of business by automatic expansion and contraction, but this issue is deprived of all such qualities by the fact that its volume is largely dependent upon the amount and price of the United States bonds.

CO-OPERATION AMONG BANKS LACKING

(5) We lack means to insure such effective coöperations on the part of the banks as is necessary to protect their own and the public interests in times of stress or crisis. There is no coöperation of any kind among banks outside the clearing-house cities. While clearing-house organizations of banks have been able to render valuable services within a limited sphere for local communities, the lack of means to secure their coöperation or affiliation in broader fields makes it impossible to use these or similar local agencies to prevent panics or avert calamitous disturbances affecting the country at large. The organizations have, in fact, never been able to prevent the suspension of cash payments by financial institutions in their own localities in cases of emergency.

NO SYSTEM OF DOMESTIC EXCHANGES

(6) We have no effective agency covering the entire country which affords necessary facilities for making domestic exchange between different localities and sections, or which can prevent disastrous disruption of all such exchanges in times of serious trouble.

NO SYSTEM OF FOREIGN BANKING OPERATION

(7) We have no instrumentality that can deal effectively with the broad questions which, from an international standpoint, affect the credit status of the United States as one of the great financial powers of the world. In times of threatened trouble or of actual panic these questions, which involve the course of foreign exchange and the international movements of gold, are even more important to us from a national than from an international standpoint.

COMMERCIAL PAPER NOT OF STANDARDIZED CHARACTER

(8) The lack of commercial paper of an established standard, issued for agricultural, industrial, and commercial purposes, available for investments by banks, leads to an unhealthy congestion of loanable funds in great centers and hinders the development of the productive forces of the country.

LIMITED MEANS FOR EMPLOYMENT OF FUNDS

(9) The narrow character of our discount market, with its limited range of safe and profitable investments for banks, results in sending the surplus money of all sections, in excess of reserves and local demands, to New York, where it is usually loaned out on call or stock-exchange securities, tending to promote dangerous speculation and inevitably leading to injurious disturbances in reserves. The concentration of surplus money and available funds in New York imposes upon the managers of the banks of that city the vast responsibilities which are inherent in the control of a large proportion of the banking resources of the country.

ABSENCE OF A BROAD DISCOUNT MARKET

(10) The absence of a broad discount market in our system, taken together with the restrictive treatment of reserves, creates at times when serious financial disturbances are anticipated a condition of dependence on the part of individual banks throughout the country, and at the same time places the farmers and others engaged in productive industries at a great disadvantage in securing the credit they require for the growth, retention, and distribution of their product.

LACK OF EQUALITY IN CREDIT FACILITIES

(11) There is a marked lack of equality in credit facilities between different sections of the country, reflected in less favored communities, in retarded development, and great disparity in rates of discount.

NO AGENCY TO ASSIST IN STABILITY OF RATES

(12) Our system lacks an agency whose influence can be made effective in securing greater uniformity, steadiness, and reasonableness of rates of discount in all parts of the country.

SYSTEM OF CREDIT EXPANSION POOR

(13) We have no effective agency that can surely provide adequate banking facilities for different regions promptly and on reasonable terms to meet the ordinary or unusual demands for credit or currency necessary for moving crops or for other legitimate purposes.

UNIFORM PUBLICITY IN SUPERVISION ABSENT

(14) We have no power to enforce the adoption of uniform standards with regard to capital, reserves, examinations, and the character and publicity of reports of all banks in the different sections of the country.

NO FOREIGN BANKING FACILITIES

(15) We have no American banking institutions in foreign countries. The organization of such banks is necessary for the development of our foreign trade.

DEFECTS IN LOANING SYSTEM

(16) The provision that national banks shall not make loans upon real estate restricts their power to serve farmers and other borrowers in rural communities.

Defects in Treasury System

(17) The provisions of law under which the government acts as custodian of its own funds results in irregular withdrawals of money from circulation and bank reserves in periods of excessive government revenues, and in the return of these funds into circulation only in periods of deficient revenues. Recent efforts to modify the Independent Treasury System by a partial distribution of the public moneys among national banks have resulted, it is charged, in discrimination and favoritism in the treatment of different banks.

The National Monetary Commission and the Aldrich-Vreeland Bill

As a result of the recommendations of the National Monetary Commission, there was presented before Congress the Aldrich-Vreeland Bill—Emergency Currency Act, which had the support of the business men and bankers of the country, in general. Its principles permitted the organization of group banks in numbers of ten, the added capital, of which, as a means of association, would amount to not less than five million dollars, and through which group organization the member banks could make application for securing the circulation of bank notes. One or two other minor emergency changes were recommended, with a trend toward centralization.

But it was evident, however, that these improvements would not suffice. There was something more needed in the banking system of the country. The nation was in need of a better credit system—some standard of commercial paper having possibilities of supporting an open discount market—liquidity of reserves—and a central head which could collect such reserves, and so use them as to be able to render assistance in times of need to any part of the country, and thus foreshadow any troublesome times in the country's economic life.

The next chapter leads us to the Federal Reserve Act and the defects which the system is remedying. Let us see, therefore, how the Federal Reserve System transformed American banking from decentralization to a basis of coöperative and centralized control, and gave to the country a credit system far superior to those previously existing.

CHAPTER III

Banking in the United States Under the Federal Reserve System

Introduction of the System; Effect.—This new system of banking was introduced and accepted by a number of institutions throughout the country in the belief that its purposes would in the end prove to be more beneficial to them. They had for more than half a century performed a useful service to American commerce and trade, and it was evident that, no matter how thorough a system the Federal Reserve purported to be, it could not, by its immediate introduction, destroy that system of American banking with its prestige of so long a time of growth and usefulness. The Federal Reserve, therefore, was introduced gradually, and its benefits were made to be realized by the banks of the country step by step.

Organization of the Federal Reserve; Centralized Banking.—The Federal Reserve Act provides for the establishment of twelve Federal Reserve banks, each of which operates in one of the Federal Reserve Districts—twelve in all into which the country is divided. The minimum capital of each of such banks required by law is four million dollars, and the subscriptions to stock of the Federal Reserve banks are required to be taken up by member banks to the extent of six per cent. of their capital and surplus.

The Federal Reserve System is on the whole a democratic one, brought out most strongly by the fact that no more than one vote is accorded any one member institution.

National banks are practically compelled to become members. Various laws to this effect, viz., non-recognition of any such national bank as a satisfactory government depository, should it refuse, within thirty days, to become a member of the System, and still further, a provision in the law suspending its charter in the event it failed to become a member within one year from the passage of the Act, virtually forced them into the System. While this is true of national banks, many State institutions have voluntarily become members.

The Federal Reserve; Organization and Management.—Each Federal Reserve bank is managed by a board of directors, consisting of nine, elected in the following manner: Every Federal Reserve District comprises a number of banks, which, by gradition, are divided according to their capital, into three groups, consisting of as many member banks the capitalization of which may be similar. The largest bank in the group of little banks, is, therefore, normally smaller than the smallest one in the group of middle-sized banks, and the largest one in the group of middle-sized banks is normally smaller than the smallest one in the group of big sized banks. One vote only being accorded to any one bank, each group is required to elect two directors, one of whom shall be a banker "representing stockholding banks," while the other shall be a business man representing the business community. The first are denominated directors of class A, and the second, directors of class B. To these six directors so elected, are added, through appointment by the Federal Reserve Board at Washington, three others known as class C directors, who are required to be of tested banking experience. Each Federal Reserve bank has, therefore, a board of nine directors, and their terms of office run for three years, one-third of which expire yearly.

Federal Reserve Board Heads System.—The Federal Reserve Board at Washington is the head of the system and manages and supervises the operations of the different Reserve banks to a large extent. Its organization includes the Secretary of the Treasury and the Comptroller of the Currency, who are members ex-officio, five others being appointed by the President of the United States, with the advice and consent of the Senate, the latter holding office for a period of ten years. The Chairman of the Federal Reserve Board is the Secretary of the Treasury. An advisory head is appointed by the board of directors of each Federal Reserve bank, making up the so-called "Federal Advisory Council." A minimum of four conferences are required to be held yearly, at which time objects of general discussion are taken up and settled.

OPERATIONS OF THE FEDERAL RESERVE SYSTEM

The Centralization and Mobilization of District Bank Reserves.—Prior to the adoption of the Federal Reserve System, all national banks, as well as nearly all State institutions, were required to keep

as a reserve a certain percentage of their deposits, usually between fifteen per cent. and twenty-five per cent., either in the vaults or such banks or in the central reserve banks denominated as such, the latter being situated in the larger cities of the country.

On June 31, 1917, an Amendment was passed to the Federal Reserve Act, requiring every bank, banking association or trust company belonging to the System, to maintain its entire legal reserve in the form of a deposit with the Federal Reserve bank of its district. Likewise, the reserve requirements of each member bank were materially made lower than the percentage required of each bank before the adoption of the System. This alone produced a great benefit to the country. Banks were able, thereafter, to make use of a larger amount of their deposits. On the other hand, concentration of the country's reserve money into a few large reservoirs made possible a much more efficient use of every dollar than under the old system of scattered reserves.

Use of Reserve Money by Federal Reserve Banks.—The Federal Reserve Banks, like other banks, though they are required by law to maintain a reserve of thirty-five per cent. against deposits, invest such funds in a way believed by them to be most profitable and most for the public good. Further, by the collection of such reserves, these banks are able to hold them in readiness in the form of money, commercial paper investments. or the like, so that in the event a need for money is found in any part of the country, the mechanism of the Reserve System enables the transfer of such funds from places of redundancy to places of scarcity, without any delay whatsoever.

Inter-District and Intra-District Mobility of Reserves.—We may now consider what is known as the inter-district and intra-district mobility of reserves. The former term signifies the mobility of reserves from one Federal Reserve District to another, and the latter, the mobility of reserves within the boundaries of one district.

INTER-DISTRICT MOBILITY

The mobilization of inter-district reserves is brought about by the three following means: First, by the rediscounting of one Federal Reserve bank for another of its commercial paper and other evidences of debt; second, the open market transactions of the Federal Reserve

banks; third, the creation of a broader discount market for commercial paper.

Rediscount Operations of Reserve Banks.—1. Federal Reserve banks are by law permitted to invest their funds in so-called eligible paper of a high standard, and in this way, a large part of their reserves are employed. Suppose, now, that there is an exceptionally heavy demand for reserve money in any one section of the country,—a demand which is heavier than the banks of that section can reasonably meet. The Reserve banks in every section where money is more plentiful will come to its aid either voluntarily or under compulsion of the Federal Reserve Board at Washington, and will rediscount the paper of the Reserve bank in the section under financial stress. This process will cause a flow of cash from the other Federal Reserve banks of the country to the Federal Reserve bank requiring funds, in this way easing the money market in the threatened section.

Advances by One Federal Reserve Bank to Another.—During the War, a practice arose amongst Federal Reserve banks to extend loans to one another, due largely to the efforts of such banks to finance issues of Government war loans. The practice of thus extending loans to one another in case of need is even to-day an important function of the Federal Reserve System.

2. **Open Market Operations.**—The open market operations of the Federal Reserve banks are the second means devised for the mobilization of reserves. While dealings with the public are somewhat restricted, it is provided, however, under Section 14 of the Act, that Federal Reserve banks may buy and sell in the open market, either in this country or in foreign countries, bills of exchange, bankers' acceptances, and other specified kinds of Government obligations. In this way, a Federal Reserve bank in one section of the country may purchase and sell eligible commercial paper and other government securities in any other section of the country, thus causing a flow of money from the district of the buyer to the district of the seller, or from places of scarcity to places of redundancy.

3. **Discount Markets for Commercial Paper.**—The third and most important method devised for the inter-district mobility of reserves is

that of establishing a broader discount market for commercial paper. Prior to the adoption of the Federal Reserve System, the country had no standard form of commercial paper, as for instance, of the class which exists in the countries of Europe.

The great discount market of London and that of France, as well as the other European financial centers, are maintained mainly by the circulation of credit instruments used in financing domestic and foreign trade transactions, similar to our trade and bank acceptances. The Federal Reserve Board was quick to see the advantage in the employment of the acceptance as a standard form of commercial paper and indicated its favoritism by discounting them at a better rate than single name paper. The Federal Reserve Board has standardized the trade acceptance and the bank acceptance and has in this way made them the basis for a discount market for the country.

THE TRADE ACCEPTANCE

To illustrate a trade acceptance, a seller of merchandise draws his draft upon the buyer, say, at ninety days sight, for the amount of the bill, and sends it along with the invoice of merchandise sold, to the buyer for acceptance. The buyer then signs, or accepts this draft drawn upon him, whereby a credit instrument is created. From the standpoint of the seller, he has acquired a definite acceptance of the goods, which the buyer cannot question in the future without a good reason, and he has a promise moreover from the buyer to pay at a definite date a specified sum equal to the amount of the invoice.

The trade acceptance has great advantages over the open account method and over the single name paper, in that it bears two names and thus gives double security, which, from a standpoint of the banker, makes it more preferable as an item of investment. A trade acceptance, moreover, can be discounted at the bank of the seller, and funds obtained with which to continue the conduct of his business. It thus prevents a tie-up of capital and releases the tremendous sums tied up in idle accounts. The buyer, moreover, obtains an advantage through the trade acceptance, in that the reflection upon his credit becomes an established fact, and he makes it known that, as a user of the acceptance, he is a careful buyer and not an over-buyer of merchandise, so conducting his business as to be able to meet his obligations when due. He, in turn, in giving trade acceptances to others, may expect the

same to be given by his customers to himself, which he could then utilize in the same way.

The banker is not subject, in his investments in trade acceptances, to the provisions of the National Banking Law, which prohibits a national bank from lending to any one customer an amount in excess of ten per cent. of the banks capital and surplus. By the process of rediscounting with the Federal Reserve Banks, the banker can at any time obtain funds in exchange for his holdings of commercial trade acceptances.

The Bank Acceptance

We may now consider the bank acceptance, which is considered a still higher form of commercial paper. Ordinarily, the credit of the bank is considered to be higher than that of the commercial firm, which, as an item of safety, is more preferred by the bankers of this country and by the Federal Reserve Banks for purposes of investment and in commercial paper dealings. It may arise in the following manner:

The seller, instead of drawing a trade acceptance on the buyer, has the buyer make arrangements with his bank whereby the seller may draw upon the buyer's bank instead of upon the buyer himself. This ordinarily gives rise to a bank acceptance, generally regarded as a credit instrument of the highest sort.

The discount and rediscount of commercial paper, principally the trade and bank acceptance, tends to establish equilibrium in reserves according to the needs of each district. By the counterflow of bank reserves from the cheaper market to the dearer ones, an equilibrium in discount rates is as well maintained.

Intra-District Mobility of Reserves

The same facilities for maintaining equilibrium in both reserves and discounts exist in the case of intra-district mobility as in that of inter-district mobility. In the former, the banks deal directly with the Federal Reserve Bank of their district, and, by the process of discounting and rediscounting the commercial paper held by them, they are enabled to equalize their cash investment position. Such banks can obtain the assistance of the Federal Reserve Bank by the discount

of their commercial paper holdings. Banks, moreover, may deal with one another, limited, however, by the rules and regulations prescribed by the Board in the case of member banks of the System.

In this way, the Federal Reserve has given to the country an elastic credit system and has laid a foundation for the creation of a discount market for commercial paper.

THE SYSTEM OF CREDIT EXPANSION THROUGH FEDERAL RESERVE NOTES

Issuance of National Bank Notes by Banks.—The second form of credit circulation exists in the issuance of Federal Reserve bank notes. Before the adoption of the Federal Reserve System, the national banks had obtained the privilege of note circulation in the usual way then provided by law, that is, upon the deposit of proper security in the form of Government bonds with the Comptroller of the Currency. National banks would then receive the privilege of issuing their notes to circulate at par. The practice of issuing national bank notes was very much indulged in by the national banks as it secured for them a double profit. The bonds which they were required to deposit with the Comptroller of the Currency, as security for the issuance of national bank notes, usually paid the bank interest at the rate of from two to three per cent. Upon the amount of money circulated by national banks in the form of bank notes they were able to earn a full six per cent., making it in all from eight to nine per cent. on their investment, less taxes of about one-half per cent.

Besides the profit accruing to the banks from their issuance, national bank notes served as one of the most important mediums of credit circulation, and it was for this reason that the Federal Reserve Board did not desire immediately to withdraw this privilege from them, but enacted laws looking forward to their gradual retirement. The amount of notes so outstanding at the passage of the Act was about seven hundred millions of dollars, and it was evident that the contraction of this important form of bank credit would work an undue hardship on the banks as well as on business.

Provisions of Federal Reserve re Note Issues.—The Federal Reserve Act provided for the issuance of Federal Reserve notes to be (a), "a first and paramount lien on all the assets of the Federal Reserve

Banks issuing them," and (b), "secured by collateral of the highest grade to the extent of one hundred per cent. of the value of circulation notes issued." The collateral secured, upon being deposited with either the Federal Reserve agents in the various districts, or with the Federal Reserve Board at Washington, secures for the Federal Reserve Banks the proceeds in Federal Reserve notes, to be circulated by them as an item of credit.

Character of Commercial Paper.—The required commercial paper must be of the following classes:

1. Such as may be indorsed by member banks and drawn for commercial, industrial, or agricultural purposes, or drawn for the purpose of carrying on trading in securities of the United States Government;
2. Bills of exchange indorsed by a member bank, and bankers' acceptances bought by the Federal Reserve Banks in the open market;
3. Gold and gold security certificates.

Security in the Form of Gold.—Forty per cent. of the amount of Federal Reserve notes issued are required to be secured by gold, pledged with the Federal Reserve agents who represent the Federal Reserve Board at Washington, and who are stationed at the Federal Reserve banks. The security may also be placed with the Treasury of the United States at Washington.

Expansion and Contraction of Reserve Notes.—The elasticity of Federal Reserve notes is made possible by the easy manner in which their circulation may be increased in times of need, and decreased in times when their circulation is not necessary. Member banks in any section of the country, may, at times require an increased supply of such notes to meet local demands. These notes may be obtained by member banks, by the rediscount of "eligible paper" with their Federal Reserve banks, the former taking the proceeds in Federal Reserve notes, thus supplying themselves with hand to hand as well as "till" money. The amount of notes issued by the Federal Reserve banks for circulation towards the end of 1918 amounted to over two billion seven hundred and fifty million dollars, secured by gold to the extent of one billion one hundred and fifty million dollars, and eligible paper amounting to two billions of dollars.

Not only may member banks obtain Federal Reserve notes by the rediscount of their commercial paper holdings with the Federal Reserve banks, but the Federal Reserve banks as well, are enabled, by the process of discounting with the Federal Reserve Board to acquire the circulation of Federal Reserve notes when needed.

The contraction of Federal Reserve note issues as an item of credit is brought about in the following way: After they have served their purpose in meeting local demands, they are again deposited with the banks, which, for the reason that the latter are not permitted to count such notes as a legal reserve, they are again deposited with the Federal Reserve Bank (Federal Reserve notes are not legal tender), to be reforwarded by them to Washington for retirement.

COLLATERAL LOANS

It so happens that member banks have at times, in their portfolios, large amounts of commercial paper and, at different times, find a need for money. However, as they are unwilling to part with their commercial paper, knowing that they might require such loans to extend only for a period of a few days, an amendment to the Federal Reserve Act provides for short time collateral loans of not exceeding fifteen days which can be made by the Federal Reserve banks to member banks, when such loans are secured by U. S. certificates of indebtedness or Liberty bonds.

CIRCULATION AND CONTRACTION OF CREDIT

The Federal Reserve System was primarily introduced for the purpose of providing a sound credit system, which, through the various means before stated, has already been found to be of great advantage to the people of the country. What is most important is the manner in which circulation and contraction of credit may be controlled. As to the former, explanation has previously been made. Regarding the latter, this is brought about by the pressure of high discount rates, which virtually compel borrowers to pay off their loans. Should this fail or halt credit over-extension, additional restrictions placed upon rediscounts would probably be recommended, which would have a direct influence upon the contraction of credit, to a normal condition.

The Domestic Clearing System

Federal Reserve Banks as Clearing Houses for Members.—The Federal Reserve Act has established a domestic clearing system for the country. Under the Act, Federal Reserve banks are empowered to act as clearing houses for members. This work of clearing and collecting can be better accomplished through the Federal Reserve banks, which are in direct relation between debtor and creditor banks, and standing between, act for both.

Operation of the Clearing System.—The present clearing and collection system as it operates under the Federal Reserve Act may be briefly summarized as follows: Each Federal Reserve bank is permitted by the Act, to exercise the functions of a clearing house in its district for member banks and for qualified non-member banks, known as clearing member banks.

Every Federal Reserve bank receives on deposit at par from member banks or from Federal Reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal Reserve bank, checks and drafts drawn by any depositor in any other Federal Reserve bank or member bank upon funds to the credit of said depositor in said Reserve bank or member bank. Member banks are not restricted from charging actual expenses incurred in collecting and remitting funds, or for exchange sold to their patrons. The Federal Reserve Bank fixes the charges to be collected by the member bank from its patrons whose checks are cleared through the Federal Reserve Bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve Bank.

The Gold Settlement Fund

Operation of Gold Settlement Fund.—The inter-district clearings of Federal Reserve banks are brought about by the "Gold Settlement Fund." The provisions in the Act relating to this function of the system requires each Federal Reserve bank to keep on deposit, with the Treasury at Washington, or the nearest sub-treasury of the United States, for credit, to the amount of the "Gold Settlement Fund" one million dollars in gold or gold certificates, and, in addition, an amount equal at least to its indebtedness due to all Federal Reserve banks.

How Settlements are Effected.—The settlement of balances between Federal Reserve banks is effected daily through the instrumentality of telegrams sent to the Board at Washington, where transfers of deposits and credits on the books of the "Gold Settlement Fund" are effected. This has brought about a decided advantage to the banks of the country. It has lowered the actual amount of funds required for clearing purposes and has greatly reduced the cost of transporting large sums of money from one place to another to effect such settlements.

FINANCING FOREIGN TRADE—DOLLAR EXCHANGE

Dollar Exchange Provided For by Act.—The Federal Reserve Act has provided through its rediscount machinery expanded facilities for the financing of American foreign trade directly by dollar exchange, that is, by bills drawn on banks and business houses in the United States, and payable in dollars, as distinguished from those drawn upon foreign centers in pounds sterling or other European currency.

Dollar Credits Come Into Use.—Prior to the adoption of the system, by far the major portion of international commerce was financed by means of the English standard, as a result of which millions of dollars in interest and commissions were paid to the English institutions. As a result of the Great War and the introduction of the Federal Reserve System, coupled with the dislocation of the machinery of foreign exchange in the financial centers of Europe, dollar credits came into large use.

Importance of Dollar Credits to American Importer.—For the importer in this country the use of dollar credits is most economical, since the risk element in the fluctuation of exchange is eliminated. The importer knows that the amount which he has to pay will be in dollars, the cost of which always remain the same. Now that there has been created a market for such paper, which is eligible for rediscount with the Federal Reserve banks, the other banks of the country are willing to buy this class of credit paper, which assists greatly the foreign trade progress of the country.

Establishment of Foreign Agencies.—The Federal Reserve Act has provided, further, for the establishment of various agencies with governmental banking institutions abroad, particularly those of England, France, Italy, Japan, Sweden, the Philippines, etc.

Up till a very recent date, national banks were permitted, provididing their capital was one million dollars or more, to establish branch banks abroad for the assistance of American foreign trade merchants. With the passage of the Edge Act for foreign financing, the national and member banks of the system have received a direct advantage in that they may now participate in the ownership by stock of corporations which may be organized for the purpose of accepting, discounting and rediscounting commercial paper in connection with American foreign trade. (Refer Part V, "Foreign Financing Under the Edge Act").

The Federal Reserve System and the Federal Treasury

Prior to the adoption of the Federal Reserve System, there was no mutuality between the national treasury and the national banks. Under the old system, the Government deposited its funds with thousands of national banking institutions throughout the country. It was thought, before the enactment of the law, that it would be well to withdraw the deposits from the thousands of banks wherein they were lodged, and consolidate them within the Federal Reserve banks. However, due to the entry of the United States into the war, and the great assistance rendered by the banks throughout the country in floating Liberty loans, assisted as they were in this purpose to a great extent by the deposits of the United States Government, a transfer of this kind was out of the question. Now, that the country is passing from a period of war financing to somewhat more normal times, it is therefore, a matter of speculation as to what will be the Government's policy in connection with the funds of the United States Government after the abnormal conditions have passed away.

Functions of Federal Reserve System

An interesting account of the functions of the Reserve banks is contained in the "First Annual Report of the Federal Reserve Board of December, 1914," quoted in part as follows:

The question naturally suggests itself and must be frankly faced: What is the proper place and function of the Federal Reserve banks in our banking and credit system? On the one hand it is represented that they are merely emergency banks to be resorted to for assistance only in times of abnormal stress, while on the other it is claimed that they are in essence simply additional banks which should compete with the member banks, especially with those of the greatest power. The function of a reserve bank is not to be identified with either of these extremes, although occasions may arise when either of such courses may be imperative. Its duty plainly is not to await emergencies but, by anticipation, to do what it can to prevent them. So also, if, at any time, commerce, industry, or agriculture is, in the opinion of the Federal Reserve Board, burdened unduly with excessive interest charges, it will be the clear and imperative duty of the Reserve Board, acting through the discount-rate and open-market powers, to secure a wider diffusion of credit facilities at reasonable rates. The Federal Reserve banks are the holders of a large part of the banking reserves of the nation, the foundation of its banking structure. Nothing should be permitted in the operation of the Reserve banks which would weaken this foundation. The resources of a Reserve bank, to be useful for its peculiar purposes, should always be readily available. It follows, therefore, that they should be mainly invested in such short-term liquid investments as can be easily converted into cash as occasion may require. This conception of a Reserve bank, moreover, implies that its investments should be marshaled in a steady succession of maturities, so that it may at all times as nearly as possible prove equal to the situation.

The ready availability of its resources is of supreme importance in the conduct of a Reserve bank. Only then can it become a safe and at the same time flexible instrument of guidance and control, a regulator of interest rates and conditions. Only then will it constantly carry the promise of being able to protect business against the harmful stimulus and consequences of ill-advised expansions of credit on the one hand or against the menace of unnatural restrictions and unnecessary contractions on the other, with exorbitant rates of interest and artificial stringencies. It should at all times be a steadying influence, leading when and where leadership is requisite, but never allowing itself to become an instrument for the promotion of the selfish interest of any private or sectional group, be their aims and methods open or disguised. It should never be lost to sight that the Reserve banks are invested with much of the quality of a public trust. They were created because of the existence of certain common needs and interests, and they should be administered for the common welfare—for the good of all.

The more complete adaptation of the credit mechanism and facilities of the country to the needs of industry, commerce, and agriculture—with all their seasonal fluctuations and contingencies—should

be the constant aim of a Reserve bank's management. To provide and maintain a fluid condition of credit, such as will make of the Reserve banks at all times and under all conditions institutions of accommodation in the larger and public sense of the term, is the first responsibility of a Reserve bank.

It should not, however, be assumed that because a bank is a Reserve bank its resources should be kept idle for use only in times of difficulty, or, if used at all in ordinary times, used reluctantly and sparingly. Neither should it be assumed that because a Reserve bank is a large and powerful bank all its resources should be in use all the time or that it should enter into keen competition with member banks, distributing accommodation with a free and lavish hand in undertaking to quicken unwisely the pace of industry. Such a policy would be sure, sooner or later, to invite disaster. Time and experience will show what the seasonal variations in the credit demands and facilities in each of the Reserve banks of the several districts will be and when and to what extent a Reserve bank may, without violating its special function as a guardian of banking reserves, engage in banking and credit operations. The Reserve banks have expenses to meet, and while it would be a mistake to regard them merely as profit-making concerns and to apply to them the ordinary test of business success, there is no reason why they should not earn their expenses, and a fair profit besides, without failing to exercise their proper functions and exceeding the bounds of prudence in their management. Moreover, the Reserve banks can never become the leading and important factors in the money market which they were designd to be unless a considerable portion of their resources is regularly and constantly employed.

There will be times when the great weight of their influence and resources should be exerted to secure a freer extension of credit and an easing of rates in order that the borrowing community shall be able to obtain accommodation at the lowest rates warranted by existing conditions and be adequately protected against exorbitant rates of interest. There will just as certainly, however, be other times when prudence and a proper regard for the common good will require that an opposite course should be pursued and accommodations curtailed. Normally, therefore, a considerable proportion of its resources should always be kept invested by a Reserve bank in order that the release or withdrawal from active employment of its banking funds may always exercise a beneficial influence. This is merely saying that to influence the market a Reserve bank must always be in the market, and in this sense Reserve banks will be active banking concerns when once they have found their true position under the new banking conditions.

It would be a mistake, therefore, and a serious limitation of their usefulness to regard the Reserve banks simply as emergency banks. Regulation in ordinary times, as well as protection in extraordinary

times, may be expected to become the chief service which these institutions will perform. The Federal Reserve Board is fully alive to its opportunities and responsibilities in this respect, but it must counsel patience in awaiting the fruition of the new system. It will take time for the new banks to develop the technique of control and skill and experience in its application. The ascertainment of the correct base from which comprehensive operations should begin, the establishment of a normal level from which expansions and contractions will freely take place, will have a most important bearing upon the future development and success of the system. Impatience to show results should not be permitted to tempt those in charge of the Reserve banks into precipitate and unwise action.

The vast and complex structure of modern banking and credit systems is one of extreme delicacy of balance and adjustment, and it must never be overlooked that it is highly sensitive to all manner of disturbances, as recent events have painfully demonstrated. The banking systems of the larger nations are closely related to one another, and financial distress or collapse at one point quickly transmits shock to all others. Safety for us in critical times will depend on the confidence our system commands, the strength of its reserves, and its power to bring them into action promptly and effectively if needed.

In dealing with new districts and entirely changed banking methods, times and experience alone can supply the data necessary for charting the course to be pursued. This consideration, if nothing else, would suggest the greatest patience and prudence, even if the European horizon were less clouded than it is to-day. None the less, the Board realizes that where extraordinary conditions warrant extraordinary measures it is the foremost duty of the Board and the banks to act promptly and boldly.

PART I

CHAPTER IV

BANKING AND CREDITS IN EUROPE

THE BANKING SYSTEMS OF

ENGLAND
FRANCE
GERMANY

PART I

CHAPTER IV

Banking and Credits in Europe

The Banking and Credit Systems in England, France and Germany

Organization of the Banking Systems in England, France and Germany

INTRODUCTION

In order that we may learn by what methods the great European nations have developed their banking systems to their present state of usefulness and importance, it would be well to consider separately the central banks of England, France and Germany, and their modes of operation, as a means of comparison with the Federal Reserve System of the United States, and as a further means of seeing how, in practice, these foreign banking systems are made to reach their desired ends.

The banking systems in England, France and Germany are organized under the central banking principle, with more or less direct supervision by the relative governmental powers, which exercise a direct control over their operations, and at times take an active part in the management of their affairs.

The Development of English Commerce and Finance

Early stages of development.—England has always been known as a commercial power, and more so as a maritime power. In the early stages of English commerce, facilities afforded by English enterprise to the commercial world, in the way of transportation by ocean carriage, attracted a large number of merchants from all nations. This advantage over other trading countries brought great volumes of business to England, and as a result, her merchants became very wealthy.

England becomes a financial center.—To meet the demands arising from increased trade and commerce, banking and financial institutions performing every function of finance were from time to time called into being and developed, thus making London a great financial power and virtually a clearing house for international settlements and a place of deposit for bankers and merchants all over the world.

The English banks, further, by the establishment of numerous branches in all parts of the civilized world brought home to the merchant of English nationality abroad a direct means of assistance, and the commerce that this particular country carried on until the outbreak of the war was far in excess of that of any other nation.

The pound sterling.—With this increasing wealth and by reason of England's financial ability to finance the trade, not only of England and the colonists, but of other nations as well, the pound sterling, which is the English standard of money, was formally established and came to be used in preference to all other forms of currency as a basis for exchange. Thus, a transaction between Brazil and England involving a shipment of coffee, or, a transaction between China and England involving a shipment of tin, or, a transaction between Japan and America involving a shipment of silk, would in the majority of international transactions necessitate the drawing of a bill on London, and for the acceptance of this draft, London bankers would charge a round commission.

The reason for this preferred use by foreign merchants of the pound sterling as a medium of exchange in international trade transactions, was that a bill drawn in the English standard of currency could always be converted into the local currency of any country at a close rate of exchange; whereas, bills drawn in the currency of other countries would have no such good markets.

BANKING AND CREDITS IN ENGLAND

Bank of England the Central Banking Institution

The Bank of England, founded in 1694, is the head and central figure of the English banking system, having the full support of the Government and receiving such support whenever it feels it necessary to have it.

ORGANIZATION OF THE ENGLISH BANKING SYSTEM; RESERVES

The Bank of England

The Central Bank of England is managed by a Board of Directors. It maintains eleven branches, two located within the confines of London and nine within the provinces. The Bank of England is the holder of the country's reserves, in the same way in which in this country, the Federal Reserve banks are the holders of a certain percentage of the reserves of the national and member banks of the System. In England, however, the central bank is not by any means the only reserve depository. Some of the outlying banks in country places deposit their reserves with the central institutions in their respective localities, which, in turn, may lodge their reserves with the metropolitan banks, which again may deposit their own reserves with the Bank of England. In this connection, the Bank of England may be said to be a bank for bankers, as are the Federal Reserve banks in the United States.

The Bank of England has many clients of its own, thus coming into direct competition with the other banks of the country. Competition in English banking is very keen. The Bank of England, furthermore, is the only note issuing bank in the country, enjoying practically monopolistic powers. It is engaged principally in the business of rediscounting, and lending on the paper of banks, firms, individuals and others.

Joint Stock Banks; Branch Banking

Joint Stock banks exist in London. The largest of these joint stock banks, to the extent of about twelve in all, together with the Bank of England, are said to control the banking operations of the country. This is made possible by the establishment and maintenance of many hundreds of branches throughout the world, controlled by such large Joint Stock companies. In England, the business of these Joint Stock companies and other incorporated banking institutions is mainly that of receiving deposits and making loans and discounts.

Private Bankers; Merchant Banks; Acceptance Firms

Private bankers exist in England in large numbers, these being very powerful. There are also in existence various so-called "merchant banks" and "acceptance firms," the business of the latter being confined mainly to the acceptance of bills on commission, though at times, they engage in the business of lending money in the English market.

Discount Houses

Discount houses follow, being important factors in the English discount market. As they specialize in their operations in the business of discounting bills of exchange and acceptances, they render a very important service to the English banks and commercial firms. The private bankers of the country, at times, deposit large sums of money with these discount houses to be loaned out and used in the business of discounting commercial paper. The discount houses also engage in syndicate operations and in lending on stock exchange collateral.

Investing and Finance Houses

Another important class of institutions in the English banking system comprises the "investing and finance houses," which are very numerous throughout the country, being situated principally in London. They engage extensively in foreign financing, exchange operations, and general investing operations. They finance industrial and mercantile firms, public utilities, and other enterprises. As a class they have at their command large sums of money which find their way into the English money market.

Commercial Paper in England

Classes of eligible bills.—The system of credit expansion in England involves both discounts and loans. The Bank of England may determine without interference what is acceptable paper for rediscount. It is a well established fact that the Bank will buy only paper with two British names, one of which must be that of the acceptor, and the maturity of which bills are not more than four months from date of acceptance. This is the only class of eligible paper. In extreme cases, however, the banks may purchase six months' bills.

Bank and Trade Acceptances the Chief Forms of Commercial Paper in England

Bank acceptances used most extensively.—The commonest forms of bills in England are those known as "Bankers' Acceptances." It may be said, by way of definition, that they are bills drawn by sellers of merchandise on bankers, the latter accepting the bills as agents of the buyers. This is the usual manner in which English banks assist in the financing of trade and commerce. They are similar to the American Bankers' Acceptances arising in the same manner. The "bank acceptance" is based generally upon an agreement, whereby the firm, in this instance the buyer, is required to furnish the bank with funds before maturity. The bank here does not lend its money, but rather its credit, and is provided with funds beforehand with which to meet the acceptance upon presentation for payment. The bank accepting the draft acts as agent for the buyer, and takes control of the goods, turning them over to the latter against a "letter of trust." The acceptor, on the other hand, gains a very great advantage in this way.

An acceptance by a high-class English bank is sure to find a ready market and will sell at a much higher rate of exchange than drafts drawn in any other currency. By reason of the extensive use of the acceptance in England, a market for this class of paper exists at all times, which directly benefits alike the manufacturer, the merchant, the trader, the banker, the investor, and generally, the commercial public.

Trade acceptances a very important form of commercial credit.—"Trade acceptances," or drafts drawn by a seller of goods and accepted by the buyer also comprise an important class of credit instruments eligible for rediscount with the Bank of England. Paper of this class bears in all cases a minimum of two names. Single name paper, which is the kind used in the United States generally, is in the credit systems of Europe, hardly recognized.

The English banks, discount and financial houses, are quick to take up commercial paper of this class for discount and investment purposes, knowing that they have at all times a ready market for their disposition if they should happen to be in need of funds. The great advantage, however, lies in the fact that by their use, billions of dol-

lars, otherwise tied up and awaiting settlement in the form of time accounts, are released to the benefit of the merchant and the manufacturer, and the burden of financing the country's trade and commerce is thereby shifted to the banker, where it properly belongs. This can best be accomplished by the maintenance of a broad discount market, such as exists in England—a discount market which is capable of collecting and controlling the resources and funds of the nation and making them available at all times where they are most needed.

OTHER CLASSES OF COMMERCIAL PAPER AND ACCEPTANCES

The Documentary Bill of Exchange

Bills of exchange.—A bill of exchange has been defined as an unconditional order in writing, addressed by one person (the drawer) to another (the drawee), signed by the drawer, and requiring the drawee to pay on demand or at a determinable future date, a sum certain in money, to the order of a specified person or to bearer.

Bills of exchange; how classified.—Bills of exchange are issued in various varieties of form. They are named and may be classified according to the time they have to run, according to the financial standing of the parties to them, and also according to the purpose for which they are created.

Demand and sight bills; short and long bills.—Demand and sight bills, short and long bills, are included among the first class above mentioned. The former are payable upon presentation to the drawee. Short bills are payable from one to thirty days after sight or acceptance, and long bills at longer intervals, usually not exceeding four months.

Prime bills; ordinary bills.—Bills are also divided into prime bills and ordinary bills, indicating the credit in the business world which the drawer and the acceptor enjoy. The former are drawn by the prominent banking and commercial houses, usually upon banks, and the latter by those and upon those not so well known. Prime bills generally sell at higher rates than ordinary bills.

Grain, cotton and finance bills; documentary bills.—Classified according to the purposes of their issue are grain bills, cotton bills and finance bills. Included also among documentary bills are such bills as may be drawn upon importers or their agents against shipments of grain or other merchandise. They are known as documentary bills, by reason of the papers which are attached evidencing the shipment and carrying title thereto. Such documents generally include a bill of lading, a certificate of insurance, an invoice, and a certificate of hypothecation. The last named certificate recites that the "seller has sold to the bank a bill of exchange drawn for so much currency, against the drawee, against a shipment of goods, as per bill of lading accompanying." Then follows an agreement with the bank or any holder of the bill for the time being, under which the bill of lading is lodged as collateral security against the acceptance and payment of the bill. In the event of non-acceptance or non-payment, it is agreed that the goods may be sold and the proceeds applied towards payment. A certificate of hypothecation may be attached to each and every bill, or a general hypothecation power furnished the banker to cover all transactions.

Drafts and documents are issued in duplicate and sometimes in triplicate sets, one set being forwarded by the first outgoing steamer and the other by steamer sailing later.

When the financial standing of the acceptor of a documentary bill of exchange is unquestioned, documents will generally be surrendered upon acceptance. If the credit standing of the acceptor is not very satisfactory, especially in the case of shipments of perishable merchandise, where it is necessary that possession of the goods be obtained promptly, documents are generally retained by the collecting agent and delivered only upon payment.

Documentary acceptance, and documentary payment bills.—When drafts are deliverable only upon acceptance, the draft is known as a documentary acceptance bill; when deliverable only upon payment, the draft is called a documentary payment bill. The major portion of English international banking business is to take up documentary drafts, either for acceptance on a commission basis or for collection.

Clean and secured bills of exchange.—Drafts known as clean bills, that is, those without documents attached, are issued usually against

credit balances abroad. Such a bill, for example, is the bank's own draft drawn on any one of its foreign correspondents. Then there are so-called secured bills, drawn in connection with the sale of stocks and bonds, which may be shipped along with the draft or forwarded under separate cover. The last method is adopted, however, only when the credit standing of the drawee, the purchaser and the securities is best known.

Finance bills.—Frequently interest rates are lower in Europe than they are in the United States, and our international bankers are quick to take advantage of the opportunity for profit, which may be gained by borrowing funds there to be loaned out here. Suppose the rate for money in New York is quoted at five per cent. In London at that time bills of exchange may be discounted at three per cent. Under such circumstances, the New York banker will draw a bill of exchange for so many pounds sterling, the maturity of which bill is, say, sixty or ninety days, upon his London correspondent who agrees to accept the bill upon presentation. This is known as a "finance bill." The New York banker is enabled to discount this bill drawn on his London correspondent, in New York. The purchaser of the bill in New York would invariably have it discounted in London. For the funds to reach London before maturity, the New York bank would have to remit to his London "accepting" correspondent, a demand draft in payment of the finance bill.

Finance bills are used by banks very frequently, and they make up a large amount of the commercial paper offered on the London market. They are a means of profit to the banks, which can secure money by the discount of such paper, loaning out the funds so acquired at a higher rate than that at which finance bills discount.

Commercial letters of credit.—Similar to the methods used, though more in the financing of American trade than that of England, is the "commercial letter of credit," which is an authorization to the shipper to draw on the bank, up to a stipulated amount, upon terms and conditions clearly expressed in such letter of credit, and which drafts so drawn the bank binds itself to either accept or to pay upon presentation. Here too, the bank is provided in advance with funds to take up the draft at maturity. For this service, the bank charges a round commission.

Advances on consignments.—English banks, as we have seen, make purchases of drafts or make partial or total advances. They also make advances on consignments of merchandise. Here, the signature of the drawer of the draft forms one part of the security and the goods form the other. The bank may turn over the goods to the firm, retaining a lien on such goods until the draft is paid, such lien being acknowledged in a "letter of hypothecation" given to the bank by the acceptors of the draft, stating that "such goods in the meantime, and the proceeds thereof, to be held by the firm in trust, on behalf of the bank, for the payment of said sum." Clauses as to insurance, sale, etc., are also continued in letters of hypothecation used in making advances on consignments.

The English banks, further, protect themselves from loss in the event the transaction results in unprofitableness to the parties concerned. A letter "of lien" or "of trust" provides that the firm "shall hold the said goods in trust on behalf of the bank, and have them duly stored, insured against fire, and remit the proceeds to the bank as and when sold. In such cases, when advancements on consignments are made by English banks, they may protect themselves in whatever way and by whatever means they think best, if this forms a part of the agreement with, and is acceptable by the firm.

THE LONDON DISCOUNT MARKET

In no city in the world has the business of discounting bills of exchange and acceptances been so thoroughly organized as in London. The business of discounting is regulated chiefly by the operations in the open market of the many bankers and brokers, and what is more important, of established companies known as discount houses, especially organized for the purpose of buying and selling bills. Furthermore, through the operations of a large group of bill brokers, corresponding in a way to the commercial paper broker in this country, the means of a prompt and extended distribution of commercial paper is provided.

It was stated by a Federal Reserve official but a short time ago that there were two hundred million dollars bankers' acceptances outstanding in the New York market, whereas there were more than two billion dollars in the London market, without considering the amount of trade acceptances in use.

What comprises the great London money and discount market.—The banking system in England, and that which comprises the London money market, consists first of the Bank of England, followed by nearly one hundred joint stock banks, the latter maintaining more than seventy-five hundred branches and employing more than one billion dollars in capital. Their resources amount to more than seven billion dollars in deposits alone. The existence of half a hundred colonial banks having resources of one billion dollars available for the London money market, branches of great foreign banks with money aplenty to use for loans and investments, finance houses making a specialty of accepting bills growing out of imports and exports, brokers of commercial paper, investors, such as insurance companies, the larger commercial firms, private bankers, private money lenders, etc., all compose the great money lending interests in London and make up what is better known as the London money market.

WATCHFULNESS OF BRITISH BANKS

British banks are vigilant of the discount operations carried on by each firm. Should they consider that the public is overtrading, they will cease buying bills, thus checking the tendency of credit overexpansion.

The Bank of England is not ordinarily obliged to continue the purchase of all kinds of bills which may be offered, but generally does purchase all such bills which conform to the "requirements." As with the Federal Reserve banks, the Bank of England is the keeper of the nation's reserves. The deposit of the reserves of the numerous banks throughout the Empire with the Bank of England operates in the same manner in which the member banks of the Federal Reserve System keep their reserve deposits with their reserve banks. Thus balances under the English banking system are likewise immediately convertible into cash, either by withdrawals or by rediscounts of paper with the Bank of England.

Bank of England discount rate.—Of great influence on the London money markets and on which in a great part other money markets are affected to a considerable degree is the Bank of England rate which is made public every Thursday. This rate moves up or down primarily in accordance with the law of supply and demand.

If the demand for funds is heavy and the supply low, the bank increases its rate, which invariably forces borrowers to pay off their loans, and so tends to stop credit overexpansion. If, on the other hand, the demands are light, rates are lowered, and borrowing is thereby stimulated.

THE BANKING AND CREDIT SYSTEM OF FRANCE

The Bank of France; creation.—The Bank of France, the organization of which dates back to the year 1800 is the central financial institution of the country and the head of the banking system. It was created by Napoleon Bonaparte, with the purpose of aiding and controlling the Government finances.

Operation of the Bank of France; reserves.—The Bank of France operates through a Governing Board, two Deputy Governors being appointed by the Federal Government, and fifteen Regents being elected by the shareholders. The facilities of the Bank of France, as those of England, are extended by means of branches, both main and sub-branches, with numerous agencies, all of which are scattered throughout the country. The Bank of France is the central reserve holding bank of the nation and is also a bank for bankers. The principles of central reserves are much more in favor of the Central Bank and its branches than in the case of the English institutions. The Bank of France is also a privately owned institution, directly supervised by the Government, and is the only note issuing bank in the country, with monopolistic powers.

Credit sociétés; their operation.—Various incorporated societies known as "Credit Sociétés" are in existence. These exercise the functions of a modern bank in every particular. It is said that in France about four big banks control the major portion of the banking business and have a large share in dictating the banking policy of the country.

In France, the incorporated banking institutions, otherwise known as "Credit Sociétés" are engaged in the business of receiving deposits, making discounts and loans, in syndicate and security brokerage operations, and in foreign exchange business, as well. In this connection, they come into direct conflict with the various banks of the country,

which has more than once brought out a strong complaint from the other banking institutions.

Private banks; their operations.—Private bankers exist in France as in England, and in similar numbers. Their business comprises dealings in notes of the Bank of France. They engage also in the business of loaning on collateral, in discount operations, and in foreign exchange dealings.

THE FRENCH CREDIT SYSTEM

Services of the Bank of France.—The services of the Bank of France are most important in connection with the discount of bills of exchange, which form the basis of the French discount market. Here, the Bank of France extends a most liberal policy. As in the system of banking in the United States under the Federal Reserve, and as in the English banking system, gold, silver, and commercial paper form the basis of the note issue in France. We have related how the Federal Reserve banks may rediscount quantities of eligible paper, and thus obtain the proceeds in Federal Reserve notes as a basis of circulation of credit. In France, commercial paper of a certain quality is likewise interchangeable for bank notes.

Credits in France; classes of eligible paper; paper discountable.—With the exception of land credits and of coöperative credits, the French credit system shows little specialization. In France, paper brokers exist to a limited extent, their operations not being as wide as those of the English paper brokers and discount houses. The elasticity of credit in France is also not as broad as in England.

The majority of paper discounted in France is for amounts of 100 francs or less, and the average time to maturity is thirty days. In France, eligible paper must bear three names, two of which are required to be of parties domiciled in France and known to be solvent. Two name bills are accepted only in cases where they are accompanied by satisfactory collateral, and where both parties are French. They are to a large extent the paper dealt in by private bankers, who, by adding their own indorsement, make it a three name paper eligible for rediscount with the Bank of France. The private bankers also make a practice of discounting each other's acceptances, the usual

charges for such acceptance accommodation being one-quarter of one per cent. for drafts which have three months to run, and sometimes going lower than this figure. A good portion of the bills discounted arise from agricultural as well as from commercial transactions.

THE EXTENSIVE USE OF ACCEPTANCES OVER THE OPEN ACCOUNT METHOD IN FRANCE

Superiority of the acceptance and bill of exchange.—As in England, the open account is replaced by the bill of exchange or time draft, and to a large measure, in the three name paper denominated as "acceptances." In supporting a discount market as exists in France, this class of paper bearing three names is of very great importance. It is easily discountable. Compared with the promissory note, the bill of exchange is far superior to the former. First, it bears behind it the responsibility of the maker; second, of the acceptor; and third, of a specific shipment of goods. So wide is the use of these credit instruments abroad, that they circulate as freely as does a check in America.

It is this system of credit, namely, the bill of exchange, the acceptance, the check and bank note, which gives to France an ideal and highly elastic credit system.

THE BANKING AND CREDIT SYSTEM OF GERMANY

The German Reichbank; its operation.—The principle of centralized banking is much more developed in the case of Germany than in either England or France. The Reichbank operates through boards known as the Cartorium, Decktorium and the Central Auschuss, respectively. A much more closer relation with the Government exists in the case of the Reichbank than in that of the French or English institutions. The German Government exercises a much more comprehensive control and paternal attitude over the operations of the Reichbank and in the conduct of its affairs, than in the English and French institutions.

The Cartorium; Decktorium and Central Auschuss.—The Cartorium consists of a body of five, who are the head supervisors. They are appointed by the Government. The active board of management is the Decktorium, also appointed by the Government for a period of life.

The last named administrative body of the Reichbank is the Central Auschuss, which is a sort of advisory committee to the stockholders. It has not the powers delegated to it which the other two administrative bodies possess, though it exercises considerable influence over the bank's business affairs.

Branch banking through the Reichbank; reserves.—The branch system of banking exists in Germany, in the case of the Reichbank, which has main branches, sub-branches and agencies situated throughout the country. The controlling factor in the Reichbank's operations is the central bank, which governs the affairs of all the dependent organizations. The ownership of the German bank is private, though this is declared by many to be but a theory. The Reichbank is the holder of the reserves of the nation and is the only note issuing bank in the country with practically monopolistic powers.

Incorporated banks.—In Germany, there exist also several hundred incorporated banks, though no more than half a dozen actually control the situation, the latter conducting more than half the banking business of the country. In the majority of cases the smaller banks in Germany are dominated by the big metropolitan institutions.

Importance of the Reichbank.—As in England, the Reichbank decides the discount rate and the rate for loans. It is the central figure in German banking, and, all other institutions in the country being in close touch with it, it is like the Federal Reserve bank, a "bank for bankers." It is a private institution, and, though with private means, is still considered to be under the control of the Government. The Reichbank confines its business particularly to the discount of short term bills of exchange, especially mercantile bills. It does not engage in the discount of credit and finance bills, as they are based upon a real money claim and are to a certain extent security in themselves, being secured by capital already employed.

Long term credits; their benefits.—In Germany the connection between industrial enterprises and the banks, is very close, this fact distinguishing it from the banking systems of other countries. The German bank is attracted by long term credits, which is quite contrary when compared with the British system. In foreign trade, these long

term credits have, until the outbreak of the Great War, been a direct means of bringing home to Germany large volumes of foreign business, and it is by these long term extensions of credit that the banking system of Germany has rendered its greatest service.

THE USE OF ACCEPTANCES IN GERMANY

The bank and trade acceptance.—In Germany, the bank acceptance is used more than the trade acceptance, as merchants prefer to draw on the bank of the buyer for acceptance or for payment rather than to have the buyer's acceptance.

Relation of German banking to industry; credits.—In the acceptance of a bill, the individual credit standing of the firm is more a factor with the banks than anything else. The German banks participate to a large extent in the industrial enterprises of the country, and are represented on the boards of directors of numerous such enterprises. This enables the banks to know better the firms with which they are dealing. They are inclined to give special support to their financial and credit problems.

The bank acceptance; how created.—The bank acceptance arises in the following way: The seller, having shipped goods to the buyer will draw on the bank of the buyer, by arrangement, for the same. The bank accepts such bill and sells the same to other bankers or in the open market. In selling a bill of goods, the merchant or manufacturer will arrange with his brokers to draw on the latter for the amount, thus anticipating payment for the goods. When so accepted, the bill is sold to other bankers or in the open market, and after indorsement, it becomes prime paper eligible for rediscount at the Reichbank. These acceptances constitute eighty per cent. of the paper held by banks. They are readily discountable in the discount market. The system of contraction and expansion in Germany is similar to that of England, where, if there is an over extension of credit, the market reacts, and vice versa.

METHOD OF FINANCING GERMAN TRADE

The German export merchant, in financing his foreign trade, selling on term credits, say, six months to maturity, and desiring to have

funds made available to him immediately, so as not to tie up his capital, in expectation of payments by the buyers at maturity, does not draw on the oversea's buyer, for this would be contrary to the terms of sale, and the draft would undoubtedly not be accepted. The seller, therefore, arranges with his banker to accept a draft drawn on the strength of the sale. The banker would then accept this draft, usually drawn for half the time, say three months, with option of renewal. The paper then becomes eligible for rediscount with the central bank. Imports are financed by the German banks in practically the same way as by the English institution.

PART II

ACCEPTANCES

Their Importance in the Fields of Domestic and International Trade and Commerce, and as a means of Creating Better Business and Credit Methods for the Country.

An Extended Survey of the Acceptance, Its Merits and Demerits, Practical Uses; Benefits to the Business Community, the Business Man, the Banker, the Investor, and the Country.

Forms, Plans, Methods of Handling Acceptances, Ways and Means Used to Encourage Their Use, a Concensus of Opinion by the Leading Associations and Organizations.

CHAPTER V

INTRODUCTORY

Historical Aspect of the Acceptance—Its Use in Europe and in the United States

The Great War has indeed worked wonders in revolutionizing previous methods and customs adhered to by the people of this country for long periods of time, and has forced developments here and there. which otherwise would have been years in getting a national hearing. This is no less true of the trade acceptance, which, as a result of the war, has had its reintroduction into the system of American credit and finance.

With the exception of the natural leaders in advanced commercial and financial methods, measures appealing to the thrift of the general business man have been without favoritism, and, were it not through the efforts of the former, whose wide experience and knowledge lead them to the adoption of the most improved methods of business, the rapid progress which has already been made in this particular field, would as yet have had to be an expectation rather than a materialization.

American merchants and business men have hitherto adhered to such great extent and have become so accustomed to the practice of conducting their business by means of the "open book account method," or, the more favorite term used in comparison with the trade acceptance method, "on account," in spite of its cumbersome, uneconomical and inelastic ways, that efforts looking forward to the substitution of better credit methods have been looked upon with suspicion.

Unlike the American, the European nations have built up so strong an acceptance business that this method is used by them as freely as we here use the open account or bank check.

Yet this great differentiation in commercial methods between the merchants of Europe and those of this country has not until a short while ago influenced the latter to adopt this better and more economical form of credit instrument. Their answers to the arguments in exposition of the trade acceptance have been that the open account system is good enough for the present.

Many of us remember how, when the automobile first appeared in this country, the wisest men would walk the streets and characterize the users of it as ridiculous. But it is doubtful whether these disclaimants of the automobile would make the same statement today.

It is an established fact that this country has been most ready to adopt in the field of specialization, methods which have proved themselves to be far in advance of those heretofore existing. In this respect, the American has by far outstripped the European.

It is with this idea in view, that the present work on acceptances has been prepared;—not for those who will not learn; but for those, who, when they discover an improved method, do not hesitate to adapt it to their needs.

It is estimated that the annual turnover in the trade and commerce of this country with present day prices amounts to more than sixty billions of dollars. Can we, therefore, overlook a saving, no matter how small a percentage, on this huge sum, in recording, in account-keeping, in expenses incident to the conduct of business, in interests, discounts, bad debts, illiquidity and unproductiveness of this huge sum of money.

THE ACCEPTANCE; ITS USE AND IMPORTANCE IN THE CREDIT SYSTEMS OF EUROPE.

The one great feature which distinguishes the credit systems of Europe and of America lies in the mode of financing the trade of the relative countries. In England, France and Germany, as well as the other countries of Europe, the acceptance circulates as freely as does currency in the form of bills and specie, and the check in America. In the European countries, the acceptance and its uses are so very greatly developed that bills in amounts as low as one dollar are in existence. For instance, in France, one-half of such commercial paper is in amounts of $20 or less, and the average bill is between $20 and $100. On the whole, it is not an easy matter to find an acceptance exceeding $5,000 in amount.

THE ACCEPTANCE MARKET IN EUROPE AND THE ACCEPTANCE AS A CIRCULATING MEDIUM RESEMBLING THE USE OF CURRENCY.

To arrive at the importance of the acceptance in Europe, it is a common fact that this class of paper is used just as freely as the bank check in this country. In the European countries, trade acceptances

are taken and held by large and small business men until maturity, or passed out by them according to their requirements in connection with the financing of their business. In this way, the merchants have an opportunity to carry the account for as long a time as they wish, and when circumstances warrant, to pass these acceptances along to the proper channels and so obtain the necessary funds with which to continue the financing of their business. In this connection the acceptance, because of its good utility, supersedes the check.

While it is true that the highly developed acceptance markets of Europe have rarely afforded any too high a rate of discount, in comparison with the much higher rates in this country, still the merchants of Europe have considered this as a principle of thrift not to be disregarded.

THE ACCEPTANCE AND ITS USES IN THE UNITED STATES BEFORE THE CIVIL WAR.

The use of the acceptance in America dates back to the time when England sent goods to Virginia and the boat took back tobacco. The manner in which an acceptance was then created was by the buyer writing the word "accepted" on the bill for the English goods, which was paid from the proceeds of the return cargo of tobacco, and, vice-versa. The use of the acceptance was continued by the Southern planters of cotton and tobacco in the United States practically up to the time of the Civil War. Following that period, at least two causes contributed to its discontinuance to a large extent, the first being the passing out of existence of the bank of the United States, and the second and contributing factor, being the dislocation of credits during the war and the desire on the part of the populace to supply itself with hard money, to the detriment of commercial paper values.

The National Bank Act passed during the Civil War created a stable currency based on the credit of the Government by means of bond issues and gold reserves. This system of credit, though it had a very sound foundation, was yet a very inelastic one, for it had its limitations. The government was able to extend its credit only on the security which it possessed, but further than this it could not go. It was not empowered to create its own credit instruments in the form of notes based upon commercial paper as security, for there was no standardization of commercial paper. Above all, the most serious handicap to the creation and development of standard commercial pa-

per was the fact that the prejudice of the banks of the country against a central banking system greatly hindered the establishment of rediscount facilities or open markets for the absorption of commercial paper. On the other hand, the disruption in credits following the Civil War had no effect upon the continuance of the use of one name paper, which system endures to this day in the United States. A great portion of the commercial transactions of the country were based upon cash payments, carrying with them discount privileges which gave to the users of this plan a high credit standing.

COMPARISON OF EUROPEAN AND AMERICAN METHODS OF COMMERCIAL CREDIT.

In the European system of credit, the acceptance is the most important of all forms of commercial paper, being used as extensively as is the check and bank note in this country. In other words, the acceptance in those countries is used in nearly all cases requiring the extension of credit.

In America, where the cash discount system is not employed, single name paper prevails. Paper of this sort is created by the seller giving his own promissory notes. The seller is, however, limited in borrowing on his own promissory notes in proportion to his credit standing.

The central banking institutions of Europe do not discount any commercial paper bearing less than two names, and the Bank of France requires as a rule three names to carry the privilege of rediscount.

Prior to the adoption of the Federal Reserve System the commercial banks of this country handled practically all of the commercial paper produced, originating from various means. The banks would discount such commercial paper, the majority of which was of a single name nature. Distribution of commercial paper before the passage of the Act was on a limited scale. The commercial paper broker was the intermediary between firm and banks and brought them together. Banks would discount the paper of their customers and would then keep it or dispose of it through paper brokers to banks and investors.

The fundamental difference in the two systems up to the passage of the Federal Reserve Act may, therefore, be seen. However, with the adoption of the new banking system in this country, a great change in credit procedure was brought about.

THE INTRODUCTION OF THE FEDERAL RESERVE ACT AND ITS RELATION TO THE ACCEPTANCE; ITS RE-ESTABLISHMENT THE RESULT.

With the passage of the Federal Reserve Act, the re-establishment of an unlimited field for rediscount of domestic trade acceptances was created by the Federal Reserve Board. In a circular of the Board dated July 15th, "trade acceptances" were made a distinct class of commercial paper, being raised to a level of great importance, and together with the newly created "bank acceptance" were made the basis of the American discount market. To encourage their introduction and use, the Board also approved the establishment of preferential discount rates. This ruling of the Board follows:

Bills of Exchange Drawn Against Sales of Goods and Accepted by Purchasers Hereinafter Referred to as "Trade Acceptances."

By regulation B, series of 1916, the Board has prescribed the conditions upon which commercial paper may be rediscounted with Federal Reserve Banks, and, by regulation J, series of 1915, rules have been promulgated covering operations in bankers' acceptances. The attached regulation is to deal with trade acceptances as a distinct class of commercial paper for which the Board is ready to approve the establishment of a discount rate somewhat lower than that applicable to other commercial paper. These trade acceptances are more particularly defined in the appended regulation P, series of 1915, and in promulgating it, the Board expresses the belief that it will considerably enlarge the scope of service of Federal Reserve Banks, and incidentally assist in developing a class of "double name paper" which has shown itself in so many countries a desirable form of investment and an important factor in modern commercial banking systems.

Regulation P, above referred to, in series of 1915, here follows:

BILLS OF EXCHANGE DRAWN AGAINST SALES OF GOODS AND ACCEPTED BY PURCHASERS HEREINAFTER REFERRED TO AS "TRADE ACCEPTANCES."

I

DEFINITION

In this regulation, the term "trade acceptance" is defined as a bill of exchange of the character hereinafter described, drawn to order, having a definite maturity and payable in dollars in the United States, the obligation to pay which has been accepted by an acknowledgment, written or stamped, and signed across the face of the instrument by the company, firm or corporation, or person upon whom it is drawn; such agreement to be to the effect that the acceptor will pay at maturity according to its tenor, such draft or bill without qualifying conditions.

II

CHARACTER OF PAPER ELIGIBLE

A trade acceptance, to be eligible for rediscount, under Section 13, with a Federal Reserve Bank at the rate to be established for trade acceptances,

(a) must be indorsed by a member bank, accompanied by waiver of demand, notice and protest,
(b) must have a maturity at the time of discount of not more than ninety days,
(c) must be accepted by the purchaser of goods sold to him by the drawer of the bill and the bill must have been drawn against an indebtedness expressly incurred by the acceptor in the purchase of such goods.

III

METHOD OF CERTIFYING ELIGIBILITY

> A trade acceptance must bear on its face, or be accompanied by evidence in form satisfactory to the Federal Reserve Bank, that it is drawn by the seller of goods on the purchaser of such goods. Such evidence may consist of a certificate on or accompanying the acceptance, to the following effect: "The obligation of the acceptor of this bill arises out of a purchase of goods from the drawer." Such certificate may be accepted by the Federal Reserve Bank as sufficient evidence; provided, however, that the Federal Reserve Bank, in its discretion may inquire into the exact nature of the transaction underlying the acceptance."

From this circular, it will be noted that the Federal Reserve Board recognizes trade acceptances as comprising a distinct class of commercial paper and subject to rediscount at rates somewhat lower (usually one-quarter to one-half of one percent.) than that applicable to other commercial paper. The Federal Reserve Board also especially commends this paper as a class of double name paper, which has shown itself in so many countries a desirable form of investment and an important factor of modern commercial systems.

The recommendation of the Federal Reserve Board to the effect that acceptances are a high grade commercial paper, commends this form of credit to the study and use of the merchants and manufacturers of the United States of America.

From the foregoing, we may, therefore, define the term "trade acceptance" as follows:

> "A bill of exchange, drawn to order, having a definite maturity, and payable in dollars in the United States, the obligation to pay which has been accepted by an acknowledgment, written or stamped, and signed, across the face of the instrument, by the company, firm, corporation or person, upon whom it is drawn; such agreement to be to the effect that the acceptor will pay at maturity according to its tenor, such bill without qualifying conditions."

Or, in other words, a trade acceptance is an order to pay, drawn by the seller and accepted by the buyer, and represents transactions in merchandise only, as stated on its face. They are time bills of exchange and serve the same purpose as a transfer of gold itself in the cancellation of debts, and are regarded by economists as a special sort of currency.

Trade acceptances are in fact two name paper and have behind them not only the names of the acceptor and the drawer, but the additional advantage of representing actual transactions in commodities.

Trade acceptances are eligible for rediscount by member banks with Federal Reserve Banks up to fifty percent, and where authorized by the Federal Reserve Board, up to one hundred percent of the capital and surplus, which again shows the high esteem in which they are held under the law.

The general use of acceptances is strongly encouraged by the Federal Reserve Board and by the various Federal Reserve Banks to the end that they may be used freely by member banks and depositors therein. The Board has shown no hesitancy at any time to do its full share towards developing the acceptance method in this country, and has given the most careful attention to its development as evidence of its practicability.

CHAPTER VI

THE AMERICAN CREDIT SYSTEM

An Analysis of the Modes of Transacting Business, and the Merits of Each System

The use of bills of exchange in the United States dates back to colonial times. They were devices employed by the States to be used in lieu of metallic money. A comparatively small proportion of them arose from commercial transactions and for this reason it could not be said that they were "trade bills." From the beginning of the nineteenth century up to the Civil War period, there was a steady increase in the proportion of this country's business done through the medium of bills drawn by the seller of goods on the buyer. It was during this time that the so-called "acceptance" played a prominent part in the commercial affairs of the country and stood relatively high as a class of commercial paper. The use of these "acceptances" during this period was as extensive in this country as it was in England then.

The Civil War, however, ushered in new conditions which demoralized commercial paper values and created a desire on the part of the business men throughout the country to acquire cash in preference to other assets. Out of this grew the pecuniary American system of cash discounts.

CASH DISCOUNTS AND CASH SETTLEMENT OF BILLS

Following the Civil War, credits in the United States were of an uncertain kind. Interest rates rose high and merchants on the whole preferred to do business on a cash basis. The cash discount became the customary inducement for the settlement of bills, and varied as it does now, but within wider limits, according to whether payment was spot cash or on the basis of ten or thirty days' time. On account of high interest rates, merchants were obliged to offer larger cash discounts as an inducement to buyers to borrow funds and use them for the prompt settlement of their commercial debts. The seller in this way relieved himself of all responsibility attendant upon the carrying of the buyer's account, and of financing

the latter's business. On the other hand, a buyer, who was not able to avail himself of the cash discount offered him, created the impression in the business community of not being in a position to borrow the money that he required for the purpose of discounting these obligations, which fact cast a certain discredit upon him. Subsequently, interest rates declined again in many lines of trade, and as a consequence, cash discounts grew less in favor until they reached a level with that of bank discount rates.

THE CASH DISCOUNT SYSTEM AND ITS DRAWBACKS

From this system of cash discounts, arose a custom widely indulged in by buyers, who, preferring not to take advantage of the discount period offered them by sellers, deduct their discount in any event, notwithstanding the fact that they overran the period of credit granted them. On account of close competition in trade, sellers are often inclined to permit this practice, thus allowing the buyer to gain an unfair advantage over them.

The consequence of a system as above described tends to increase prices inasmuch as it is then necessary for the seller to figure the selling price high enough to cover the loss arising from this improper deduction. Again, from an apparent advantage to the buyer, there arises a disadvantage, for he still believes that he is obtaining a large discount and so discounts his obligation, not figuring that the process renders it altogether more costly to him on account of the increased price of merchandise.

Another inconvenience arising from the cash discount system is that many buyers are unable to acquire cash on the moment to take advantage of discount opportunities and to make separate loans for the purpose of discounting each bill as it comes in. The cost of the merchandise, therefore, to the smaller buyer is much more than to the one who is able to take advantage of the cash discount. The smaller buyer, therefore, must seek higher prices for his goods, making the process of selling for him much more difficult, which deprives him of the fullest benefits.

THE OPEN ACCOUNT SYSTEM

Another way in which American trade is generally carried on, and upon which basis most transactions are effected, is by the open account system, whereby the seller enters upon his books a "debit" against the

account of the buyer, which represents a sum owing to the seller. This system is generally most availed of in credit transactions. Open accounts are usually known as "book accounts" and act as substitutes for promissory notes and cash discounts. Under this system, the chief evidence of the indebtedness of the buyer to the seller is the record on the seller's books.

The open account system holds out many disadvantages. Suppose a seller has a need for money but has not his customers' notes to discount at his bank. He is able to procure a loan only upon the discount of his own paper, that is, by giving his own notes, secured by his open book account. Another way of realizing on book accounts has been to sell or assign them outright to a bank or commission house, which assumes all risks and charges a high rate of interest, and perhaps a bonus in addition. The assignor receives only a limited amount on his book accounts, the assignee permitting the former to collect the accounts when due, but requires the substitution of other accounts to maintain the agreed upon ratio. In this way, the borrower's credit may suffer somewhat, due to the fact that his customers may learn that he has assigned their accounts to obtain funds.

The evils attending the open book account method are many and serious. It permits the buyer to hold off payment past the date of maturity. It results in a loss of interest charges to the seller. It limits the activities of the seller in that he must wait until he realizes upon his accounts. The seller, as a result, must borrow on his available assets, and, in whatever form, if his credit is not so high as to acquire for him a moderate loaning rate, on his own note, he is forced to sacrifice more than is necessary if he must assign or borrow on his book accounts.

The system of open accounts is attended by numerous other abuses and unfair practices. It results in slow collections, bad debts, and unnecessary losses. Another very serious evil in the open book account method is that the only evidence the seller has of a debt owing to him is the entry upon his books, which must be proven to the satisfaction of those in authority. Furthermore, when the time comes for settlement, the buyer may always produce arguments whereby deductions are forced to be given for unreasonable and unfair claims, shortages, and losses that are questionable, short weights, trade discounts, and various other objectionable methods.

SINGLE NAME PAPER

It has become customary in recent years for merchants, who have acquired a good credit standing, to sell their promissory notes to the public

through brokers in commercial paper. These are largely purchased through commercial paper dealers by the banks who ultimately distribute them among investors for the employment of the latter's funds. A considerable proportion of these notes is single name paper, which is sold upon the credit standing of the maker. The only responsibility assumed by the broker is for the genuineness of the signature. When money is easy, there is a wide market for this class of commercial paper, but its buyers must depend entirely upon such credit information as they can obtain regarding its intrinsic value. Single name paper is bought and sold on faith alone. The merchant financing himself through the discounting of his own promissory notes is required to file a statement of his financial condition periodically. The process of discounting single name paper is often carried to great abuse, for it is an uncertain matter as to the amount of such paper which a maker may have outstanding at a given time. There is further, no indication as to the occasion of its origin.

SINGLE NAME PAPER PREDOMINATES

Of the classes of commercial paper in use at the present time in the United States, single name paper predominates. It is estimated by well informed commercial paper brokers that fully ninety percent of the paper traded in is of the single name class. At the passage of the Federal Reserve Act, trading in paper of this nature was the nearest approach to a discount market here.

Included in the class of promissory notes is such commercial paper as is given by buyers to sellers or by debtors to creditors. The purpose of their origin here may also not be known. The credit of the buyer is not of so great concern to the bank which is offered the paper for discount, but the credit of the seller is looked upon as the main security.

The one serious objection to the single name paper method of financing, is that it is not known why the paper is in existence. It may have been given in settlement of a past due obligation. It may have been used for purposes other than those involving the sale of merchandise, and it may have been given for services.

The disadvantages and abuses arising out of the open book account method have long been realized by the commercial and credit world.

What was sought by the business men and bankers was the adoption and standardization of some form of commercial paper which would eliminate most of the disadvantages of the open book account method—something that would stabilize and liquidate commercial credit by convert-

ing the sale of merchandise into a liquidated credit, immediately available at reasonable interest rates to meet the financial needs of the business world.

Recently, there has set in a movement for the substitution of the "trade acceptance" in place of the open account.

CHAPTER VII

Procedure in the Use of Acceptances

Nothing strange in acceptance method.—There is nothing strange in the acceptance method—nothing in any way that differs from usual business customs. The users of the acceptance method forfeit no rights which they otherwise have under the open account system. It is not intended to supersede all other existing methods of transacting business. It is simply a system designed to create better credit conditions and sounder business methods.

Acceptance a class of standardized commercial paper.—In the preceding chapter, there was explained the use of the acceptance in this country up to the Civil War period, and the causes which contributed to its decline. Though used in a small way following the Civil War up to a very recent date, the acceptance method, however, has always existed in one form or another, but its standardization and recognition was not made a fact until the adoption of the Federal Reserve System.

Earlier substitutes of the acceptance.—The nearest comparison to the acceptance as used today and as approved by the leading organizations of the country, was the two name paper of the class generally denominated as "drafts." These "drafts" were generally drawn by sellers of goods upon buyers and accepted by them, but their handling was not made a systematic and uniform method of procedure.

The "draft," as commercial paper, may have arisen in various ways, —not exclusively from merchandise transactions. "Drafts," furthermore, as used before the general adoption of the trade acceptance method in this country, were made payable to third parties or to the order of the drawer and could be realized upon for the purposes of discount, by indorsement of the drawer. They were not payable at any bank specified by the buyer, and contrary to the legal distinction of the modern trade acceptance, the bank of the buyer was completely out of the transaction, and was not obligated to pay the amount of the instrument on behalf of the buyer.

The fact that drafts could originate both from trade purposes and from past due obligations, or dealings not involving the sale and purchase of merchandise, made them an uncertainty as to commercial standing and questionable as to the security behind them. In this connection, they were no better than the seller's own promissory notes and together with the latter were the predominating class of commercial paper in this country. Even today single name paper exists to a greater extent than all other forms, followed by the acceptance.

TRADE ACCEPTANCE

Purpose of acceptance.—The purpose of the trade acceptance system is to supply a means for the settlement of accounts by "trade acceptances" and it is designed as a substitute for the open account in all cases where business is not conducted on a cash basis or by the giving of promissory notes.

Acceptance not adaptable to every kind of business.—The trade acceptance is not adaptable to every kind or branch of business, and the entire question of such adaptability must be decided upon from the particular nature of the business.

For instance, it could not be expected that the trade acceptance should act as a substitute for a system of cash settlements where business is conducted entirely upon that basis. Neither could it be expected to offer any greater facilities in the conduct of any business which is based upon the periodical settlement of bills on short terms, of say, a few days, for that is practically equivalent to a system of cash settlements.

Acceptance a scientific credit instrument.—The acceptance represents generally a convenient and scientific kind of credit instrument which could be used to great advantage in all lines of business not upon a cash or upon a short term basis.

Acceptance and note distinguished.—The trade acceptance must be distinguished from a promissory note or a sight draft. A note is drawn by a person, whereas an acceptance is drawn on a person. Trade acceptances are used entirely for different purposes than are promissory notes. Promissory notes are used generally for the purpose of borrowing money and for the settlement of past due obligations. The

underlying basis of the trade acceptance is that it is drawn by the seller of merchandise on the purchaser for the purchase price of the goods sold, that is, arises from present values. When accepted, the trade acceptance constitutes a valid promise to pay on a specified date. It is a negotiable instrument, the same as a note. The trade acceptance is used in current transactions only. It has nothing to do with any purposes other than those arising from a transaction involving the sale of goods. It cannot be given for borrowed money or past due obligations.

Trade acceptance arises from sale of goods.—The trade acceptance expresses an obligation arising from the sale of goods. In order to understand the simplicity and procedure involved in its operation, an example beginning from the time of sale to the time of discharge of all parties concerned, is given in the following:

Making of sale on terms of "trade acceptance."—A seller having been in negotiations with a buyer, has consummated a deal for the sale to the latter of a quantity of merchandise at a stipulated price, with a definite term of payment agreed upon. The location of the buyer and seller is immaterial. The credit of the buyer, it must be assumed, has been considered by the seller, and all terms of the sale are ready to be carried into effect. Assume, also, that the merchandise has been sold on terms of "trade acceptance," having a maturity of ninety days.

Drawing of trade acceptance by seller on buyer.—The seller then draws his trade acceptance on the buyer, stipulating thereon that it arises from the sale of goods, and forwards it to the buyer together with his invoice for the goods sold. Other papers, such as weight sheets, bill of lading, delivery order, etc., may accompany the trade acceptance. (For forms of trade acceptances in use, see Part IV. For ordinary use, Form No. 1 is recommended as the best. However, other forms are equally well adaptable for other classes of business and it is a matter of choice with users as to which form is most advantageous to them).

Buyer "accepts" thereby certifying to correctness of sale.—The buyer then examines the trade acceptance, the invoice, and the other papers, if present, to see that all terms of the sale are in accordance

with the original intent of the buyer and seller, and after convincing himself that the conditions of the sale have been complied with and that the trade acceptance is in proper form, and after he is willing to assume that title to the goods has passed to him, he accepts the trade acceptance by writing across the face of the instrument the word "accepted," the date of acceptance, and the place of payment. If it is a firm, the name of the firm and the individual conducting business thereunder, is signed in the acceptance.

Place of payment.—The place of payment is usually the bank of the buyer. By the Negotiable Instruments Law, uniform in the majority of States in the Union, a trade acceptance payable at a designated bank acts in the same manner as a check, and upon presentation for payment at maturity at the bank of the buyer, providing sufficient funds are there to meet it, it will be paid the same as a check. Five states in all do not recognize the negotiable Instruments Law and an acceptance therefore in those states, does not take the form of a check. After being accepted in the above form, the buyer returns the trade acceptance to the seller.

Presenting draft for acceptance and payment.—If the seller prefers, he may present the acceptance to the buyer himself together with the bill. On the other hand, if he think it more desirable, or if the buyer is not in his town, he may request his bank to handle the acceptance and collection of the draft, in which case he would give to the bank all papers necessary to the transaction, together with the acceptances. The bank would then present the trade acceptance to the buyer on behalf of the seller, and after having been accepted by the buyer, it would either be held by the bank to maturity, when payment would be made by the buyer. In this connection, the seller, has his choice. He may either receive from his bank the accepted paper, holding it to maturity, when he would again hand it back to his bank, or he could request the bank to hold the acceptance until maturity.

Negotiation of accepted paper.—After the seller has received the accepted paper, he may arrange to have it negotiated. By this is meant that the seller may have the trade acceptance discounted, in which case are brought together the acceptor, the seller, the bank, the note broker and the Federal Reserve Bank. The position of the seller is that of the holder of the accepted paper. The buyer figures as the party obligated to pay the acceptance at maturity. The note broker or

commercial paper broker is the intermediary between the seller and the bank. To him is generally given the work of selling the accepted paper to some bank or investor. The seller may deal with the bank direct, but in this case it is the general opinion that he is benefited much more by letting the broker handle the transaction, as the latter is familiar with the market for commercial paper and generally knows where the greatest demand for the same exists, thereby being enabled to obtain the best rate of discount.

Rediscounting of acceptances.—After the acceptance has been discounted with the bank or discount house, it may be held by the latter in its portfolio until maturity. It may, however, be rediscounted with the Federal Reserve Bank, if its maturity does not exceed ninety days, and if it otherwise conforms in all respects to the requirements of the Federal Reserve Board governing eligible paper. Acceptances, however, arising from commercial transactions are the only ones which are eligible for rediscount with the Federal Reserve Banks, notwithstanding their maturity exceeds ninety days, but which must not exceed six months. The Federal Reserve Banks are the largest purchasers of this class of commercial paper, and at the present time are really the supporters of the American discount market. It is like a financial balancing wheel to the country and places the obligations of seller, buyer and banker in that part of the country which can best meet it. It standardizes commercial methods. It creates bankable paper of a class much more valuable than the open book account.

Recording and accounting.—There are no difficulties to be experienced by users of the acceptance method, either the buyer, the seller or the bank, in the bookkeeping, and recording of trade acceptances. They are essentially the same in nature as the ordinary bills receivable. In Part IV, the very last form is an illustration of a so-called acceptance register. Entries are made therein according to the date of receipt of the accepted paper. At the time of sale, an entry similar to that made under the open book account system, is recorded in the sales books of the seller. As the acceptance operates as a settlement of the transaction representing in itself a liquid asset, and in place of the seller's assets in the form of open accounts, it is therefore applied as a credit to offset the debit account of the customer arising from the sale of the goods. An account would be created such as "Trade Acceptances Receivable" or "Acceptances Receivable." Expressed in simple account form, entries would be made as follows: Upon the sale of goods;

"Dr. Customer
Cr. Merchandise"

At the time the trade acceptance is received:

"Dr. Trade Acceptances Receivable
Cr. Customer."

At the time the trade acceptance is paid:

"Dr. Cash
Dr. Less charges if any.
Cr. Trade Acceptances Receivable."

Collections and other charges.—Banks usually charge a customary rate for the collection of trade acceptances, of from 1/20th to 1/10th percent of the face amount of the instrument. This charge is generally borne by the seller. Acceptances, as time paper are taxable under the Federal Revenue Act. This charge may be carried either by buyer or seller, depending upon the prior understanding of the parties. (Refer Part V, Taxation of Negotiable Instruments.)

Rediscount of acceptances with sources other than Government.—The bank is also enabled to have the paper rediscounted with so-called discount houses which make a specialty of this class of business. They act in the capacity of banks, purchasing the commercial paper for sale at an opportune time.

Discharge of acceptor or extension of time.—The acceptor either pays the draft at maturity or secures an extension of time. To secure an extension of time, it would be necessary for the acceptor, that is, the buyer, to have a definite agreement with the seller. If the buyer's business reputation is of a fair standing and his business ability recognized, he should meet with no difficulty in obtaining an extension of time, should he find it necessary.

Summary of procedure.—Summed up, the procedure would be:

First, the sale;

Second, the drawing of the acceptance by the seller on the buyer;

Third, the acceptance by the buyer and the return of the same to the seller;

Fourth, the keeping of the acceptance until maturity by the seller, or the discounting of the acceptance with a bank or discount house, direct or through the intermediary of a commercial paper broker;

Fifth, the rediscount of the acceptance by the bank or discount house with the Federal Reserve Bank; and

Sixth, the payment of the acceptance and the closing of the transaction.

Comparison between acceptance and open account.—How then does the acceptance compare with the open account method? The accepted paper gives to the account a general liquidity. It may be realized upon through the process of discounting and rediscounting, with greater ease than the open account. It releases the billions of dollars tied up in open accounts, awaiting settlement, and enables the seller thereby to do a greater business on a minimum of capital employed.

Elsewhere in the following chapters, there are given outlines of the advantages to the buyer, to the seller, to the banker, to the consumer and to general business, of the acceptance method, in comparison with the open account. It is, therefore, unnecessary to detail such advantages at present. The bank takes over a very important form of banking business and practically takes from the hands of the seller the burden of financing both himself and the buyer.

The acceptance makes for better business methods, is more safe, more economical and much more practicable than the open account method. It is a sort of governor to general business. It creates a cycle of liquidity between commerce and finance.

CHAPTER VIII

THE BUYER AND THE TRADE ACCEPTANCE

The Buyer Considered

Notwithstanding the advantages to the seller and the banker as well as to general business through the employment of the acceptance method, it has been asked time and again by the buyer "What benefit does the acceptance give to me?" There is a feeling prevalent among buyers, though they are themselves sellers, that the acceptance method is of disadvantage to them. However, this is not so. The mistaken impression that the buyer has formed to the effect that the acceptance is not practicable for his use may be due to the fact that previous discussions have not been directed to stress such advantages to him in the proper way. Apparently we have acted as though we consider this the weak end of the situation. The arguments we give to the buyer are very much like those of the old lady who is handing her son a lot of bitter medicine, not because he likes it but because it is good for him and may help him later on. Further than this, the buyer has considered that the acceptance is more or less being forced upon him, and its advantages, if it has any, are for the benefit of the seller and not for him. In order that this conviction may be overruled, it is the purpose of the present chapter to outline, though briefly, at least some of the advantages which the buyer derives from the acceptance method.

ACCEPTANCE STRENGTHENS CREDIT POSITION OF BUYER IN THE ESTIMATION OF HIS BUSINESS ASSOCIATES

The trade acceptance improves the business standing and credit of the buyer in that it gives to the seller a negotiable evidence of indebtedness with a fixed maturity date. The buyer in this way puts himself in a class of preferred merchants in much the same way as those who discount their bills for cash, since the acceptance in the hands of the seller could be discounted without an immediate payment of money by the buyer, in settlement of his obligation.

The impression conveyed to the seller by the willingness of the buyer to "accept," raises the credit standing of the buyer in the seller's estima-

tion. The buyer, by giving the acceptance to the seller, reduces the debt to writing, thereby demonstrating his good faith in the transaction.

As a concrete example, the majority of raw silk importers and dealers in this country do not care to sell their products to even the best of houses if the basis of credit does not embody the giving of a trade acceptance. A certain firm operating no less than two dozen mills will not be sold by one of these raw silk importers on open account to the extent of a ten bale shipment, whereas, if trade acceptances are the basis of sale, merchandise will be sold on credit to the extent of two hundred and fifty bales. It is evident from the above that the credit standing of the buyer be raised in the estimation of the seller, and serves as an indication of how some houses prefer an acceptance and will not hesitate to extend the limit of credit to buyers who will use it.

The seller desires the acceptance, not because he may or may not be in need of the money, but because he wants to be assured of liquidity of his assets, afforded by the acceptance. May it not, therefore, be said that the acceptance serves to strengthen the credit of the buyer? Not alone this advantage, for the acceptance puts the buyer in the position of a preferred purchaser, as the giving of an acceptance entitles him to better consideration, which, if he knows his ground, he will invariably be successful in obtaining.

ACCEPTANCE DEVELOPS CAREFUL BUYING

A buyer who gives trade acceptances will buy more carefully. This is true, because if he knows that he has to meet payments at definite dates, he will not overbuy. A great deal of overbuying is done honestly but through poor judgment. If a buyer knows he must meet those obligations strictly, he will realize the necessity of exercising most careful judgment. The acceptance is, in other words, a regulator of business for the buyer and is of direct benefit to him. Naturally, one must always guard against a man who is inclined to overbuy from questionable motives. The acceptance, therefore, prevents overbuying, and indirectly benefits the buyer by keeping him away from the dangers prevalent in credit over-extension.

ACCEPTANCE OF BUYER RENDERS HIS CREDIT AS TANGIBLE AS CASH

The mercantile agency of R. G. Dun & Company, in asking the business houses of the country for a statement as to their financial standing

to serve as a basis for judging their credit, emphasizes the fact that credit is as tangible as cash and should be guarded and used accordingly.

It is a proven fact that the European countries using the acceptance do at least five times as large a business with the capital which they employ as the United States does with its own. It is therefore, self-evident that the Europeans know how to use credit better than we, and in using this credit privilege, they take care not to abuse it. The evils flowing from the open account system of transacting business are such that they work at a disadvantage to the buyer in the end. By the use of the acceptance, the buyer cannot help but pay more attention to its purpose and more attention to the strenuous nature of its obligation.

THE BUYER AS THE SELLER

Buyers on the acceptance, in conserving their credit ability, and establishing their credit standing, are therefore enabled to employ it to a greater extent than money itself.

The buyer, being at times the seller,—it must be remembered, if he advances the argument that he is not receiving as much benefit as the seller derives from the acceptance method, that his condition is frequently reversed and that he himself is as frequently seller as he is the buyer. If he gets acceptances from his trade, he cannot very well refuse to give them when his seller asks for them.

ACCEPTANCE AFFORDS BUYER BETTER TERMS OF SALE

In order that the buyer may receive the maximum of benefit from the trade acceptance, it will be necessary that he understand, first, the procedure involved and its use, thoroughly. The more the trade acceptance is used by the buyer, the more consideration he can demand. In other words, he must be on his job or else he is not going to get the advantage he is entitled to. He must know how to put it up to the seller that he is entitled to an advantage. He is giving the seller what the seller wants,—a trade acceptance. He is giving the seller something that is of value to him, whereby the latter acquires a good deal of advantages otherwise lost in the open book account system. This is worth something to the buyer, and if he is a wise buyer he will get something that no open account could get for him. Moreover, many sellers throughout the country who use the trade acceptance in their business, offer considerable advantages to acceptor buyers, in price, terms, discounts, etc.

ACCEPTANCE OF ADVANTAGE TO SMALLER CONCERN

The giving of a trade acceptance will do more for the small buyer than the open account method can do for him, because it will enable him to operate in competition with the bigger concern. As an example, let us take the case of a small jobber of limited capital. Let us assume that he is careful and efficient and has an opportunity to buy a quantity of goods at an advantageous price. Let us further assume the price of the goods to be One Thousand Dollars. He knows where he can make a turnover at a few hundred dollars profit. He knows also that he can buy on ninety days' time and that he will have to sell on ninety days' time, but there is a little gap of time in between the day he has to pay for the goods and the day he gets his payment, due to delivery, handling of the order, etc. He could not very well handle this transaction on open account for the bank would not lend him more than half of the selling price of his accounts receivable, besides requiring a deposit as additional security. In other words, the amount he could loan will be far less than the amount required for the carrying out of the transaction.

But if the small buyer resorts to the acceptance method, how easily this transaction could be financed. If the jobber knows where the goods are and where they can be bought and sold, he may give his acceptance for the purchase price at the time of buying. The seller's bank will cash the buyer's acceptance for him and give him his money. The jobber then takes the other man's acceptance for the selling price, turns it into his own bank and cashes his profit. The entire transaction is completed and the buyer has profited thereby. It has not cost him a dollar of his own money—a rather easy accomplishment. The procedure enables a small retailer to operate on a more extensive scale than would be possible on a cash or open account basis, where he has to go in and borrow the money required for the transaction.

ACCEPTANCE DEVELOPS SOUNDER AND MORE SERIOUS ATTITUDE TOWARDS BUYER'S OWN OBLIGATIONS

Buyers frequently allow their accounts to accumulate to such an extent that they find themselves at times in a very embarrassing position, which invariably places great hardship upon them. This is especially so under the open book account system, where the buyer, not because he wants to, but for the reason that the conveniences afforded by that system permit him to entail great credit responsibility, finds sooner or later that the practice is a very dangerous one. Where credit is extended in no definite

amount and where it is easy to be obtained, a general tendency towards speculation sets in. It usually works out to the buyer's disadvantage.

The acceptance prevents the accumulation of over-due accounts and develops a sounder attitude towards the buyer's own obligations. He realizes his credit privileges, and takes care that they are always available to him in his business. It develops for him also, the tendency of regulating his business according to the extent of his assets. The acceptance, therefore, to the buyer, may not appear to be of advantage to him directly, but its use produces an indirect benefit, enables him to keep better tract of his outstanding obligations and avoids the evils of over-extension.

ACCEPTANCE BENEFITS BUYER BY REDUCING PRICE OF GOODS

In a previous topic contained in the present chapter, one advantage was given accruing to the buyer from the use of the acceptance, as a means of settling his obligations, in that he offers the seller a better credit instrument which is worth something to him. The buyer, if he knows how to use this argument in making his purchases, will generally be able to obtain greater privileges than the buyer on open account.

The open account system of transacting business is accompanied by great evils which indirectly tend to raise the selling price of goods. For instance, the seller, due to the fact that losses are greater under the open account system, and that costs are higher as regards collection and account carrying, loss in interest, capital tied up and reduction in merchandise values, is forced to raise the price of his goods and must seek to get back this increase from no other source but the buyer. The seller knows that if he has a trade acceptance of the buyer in his possession, he is able to obtain funds at any time by discounting the paper. He knows also that the cost of conducting business due to the elimination of risk involved in the open account method is materially lessened.

It will invariably be found that the seller, therefore, is willing to show his appreciation of the acceptance method of settlement by affording the buyer a better consideration, which is usually a lower cost of merchandise. The large users of acceptances in this country offer buyers better selling terms, that is, a longer time within which to effect settlement in money by the trade acceptance method, knowing that thereby their capital is not tied up and could be made available to them at short notice. In other words, the buyer who buys goods on the open book account method, is paying for the inefficiency of that system. He has to pay, or the seller

cannot stay in business. Therefore, anything that he can save the seller can be received as a concession by an "acceptance time buyer" just as well as by a "cash over the counter buyer."

BUYER BENEFITED BY THE EXTENSION OF CREDIT UNDER THE ACCEPTANCE METHOD

The buyer is able to extend his operations with greater facility through the acceptance than is possible under the open book account method. The advantages which the buyer receives from a reduced price of merchandise and from better credit and sales terms on the acceptance basis, permit him to conduct his business more economically and with a lower capital amount than is otherwise possible. He is then enabled to either sell his merchandise at an increased profit or increase his sales through lower prices, thereby greatly extending his business.

BUYER DOES NOT WAIVE ANY LEGAL RIGHTS AGAINST SELLER WHICH HE WOULD OTHERWISE ENJOY UNDER OPEN BOOK ACCOUNT METHOD

It is generally thought by buyers that the giving of an acceptance forces them to give up their legal rights which they otherwise retain under the open account. The buyer under the open account system can always contest the correctness of the details of the merchandise transaction, such as wrong deliveries, goods not up to standard, short weight, etc. By the giving of a trade acceptance, it is true that the buyer does obligate himself to its payment at maturity, but he thereby does not give up any legal rights against the seller if he pleads incorrect deliveries, short weights, or if he has other complaints against the seller contrary to the original intent of the parties at the time of sale. In contesting the validity of the transaction, he must however, prove his case affirmatively.

But this point, however regarded, should not be an obstacle in the way of adopting and using the acceptance method, for the buyer may satisfy himself as to all conditions of sale, express or implied, to see that they are correct in all details, before accepting.

THE BUYER AND THE BANKER

Acceptance Raises Banker's Estimation of Buyer

The best bankers consider the trade acceptance method as far superior to the open account system, or to the single name paper method of

financing business transactions. The appearance in the buyer's financial statement of "acceptances payable" instead of "accounts payable" convinces the banker that the buyer practices careful habits, that he is discretionary in his business, and that he is careful in his credit dealings. The use of the acceptance method by the buyer is looked upon by the banker as more businesslike than the open account method.

CHAPTER IX

The Seller and the Trade Acceptance

The following are a few advantages which the seller receives through the use of acceptances in substitution of the open book account.

THE ACCEPTANCE PROVIDES A LIQUID ASSET

What is of very great importance to the seller in the use of the acceptance, is the fact that he thereby gains a means of realizing upon his open book accounts, in rapid time, if necessary. Under the open book account method, there are two means which the seller may avail himself of, in order to secure funds, the first being the discounting of his own paper or promissory note, and the second, selling or assigning his open book accounts. The disadvantages of these two methods of realizing upon the seller's assets not only cause a loss of time, but result in unprofitableness to him, for the procedure in the second method of assigning accounts is a costly one, besides conveying an unbusinesslike impression. Neither does the giving of a seller's note gain for him the privileges which the acceptance does.

The trade acceptance, however, gives to the account liquidity, and the seller may realize upon it at any time, through the process of discounting. His capital assets are thereby put into liquid shape. The use of the trade acceptance would remove the necessity of the manufacturer or jobber, with somewhat limited capital, to borrow so heavily, in order to act as banker in supplying credit to customers, and a broader market would be opened for his paper at most favorable rates.

ACCEPTANCE RELIEVES SELLER FROM FINANCING CUSTOMER

Under the open book account method, considerable burden has to be carried by the seller of merchandise, in that he is obliged to practically finance the buyer, through means of credit extensions. His

operations are, as a result, limited and he must wait until he realizes upon the buyer's obligations. The open book account method, moreover, does not afford any liquid asset to the seller, and for this reason, a like burden is imposed upon him in the financing of his own business.

By the trade acceptance method the seller may dispose of the acceptances representing the accounts of the buyer, obtaining thereby available funds according to his needs and thus relieving him from financing the buyer. This is accomplished by discounting his acceptances.

ACCEPTANCE CREATES A SYSTEMATIC BASIS OF INCOME ON SELLER'S ASSETS

A seller receives great benefit from having his accounts in the form of acceptances, as he then knows that he will receive stipulated sums of money as the acceptances mature. He is, therefore, enabled to conduct his business along the lines permitted by the extent of his capital and income. The seller is, moreover, relieved from unnecessary worries, knowing that at each maturity, he will have so much with which to continue the operations of his business. In other words the seller has more certainty as to payment at definite periods.

ACCEPTANCE TENDS TO CONFINE BORROWING TO FUNDS ACTUALLY NEEDED

Sellers invariably find themselves in need of funds at different times, with which to tide them over some difficulties in their financing. If they are forced to dispose of their assets in the form of open book accounts, in the limited ways open to them for this purpose, they will find that the operation is a very costly one.

At one stated period, a seller may be in need of a limited amount of funds, but if he must count upon realizing on his open book accounts, the safest way is generally to figure the amount of money to come in as much less than is owing to him. The result is that he is forced to borrow more funds than are actually needed to carry on his business. With the acceptance, this condition is remedied as the seller knows the exact amount of money that will come in as a result of their maturing.

One advantage of the acceptance, and to which bankers and business

men throughout the country, who, as users and advocates of the acceptance will testify, is that trade acceptances are generally met promptly when they fall due. In rare cases is an extension of time required or asked for.

ACCEPTANCES RELIEVE SELLER FROM NECESSITY OF SELLING OR ASSIGNING OPEN BOOK ACCOUNTS

A general practice among business men who conduct their transactions under the open book account method, and who find themselves in need of funds, is to realize upon their open accounts. To effect this purpose, it becomes necessary for them to "sell" or assign these accounts. During the past decade, there have come into existence numerous commission bankers and commission houses, which make a specialty of buying "accounts receivable," that is, open book accounts, and make advances thereon to the seller.

Commercial bankers and commission houses engaged in this kind of business usually charge a much higher rate of interest, or discount open book accounts at a much higher rate than the customary charge for discounting trade acceptances. The operation is, therefore, a costly one, and is unprofitable to the seller.

Should the seller who holds trade acceptances find himself in need of funds, he may acquire same through their discount.

ACCEPTANCES PERMIT OPERATION OF A SO-CALLED "BUDGET SYSTEM" OF FINANCING BUSINESS

Governments, as well as the larger commercial and financial organizations of the country, have learned from experience that the safest way to conduct their financial affairs is on the plan of a budget, that is, on an income and expenditure schedule. The seller, for instance, is able to calculate the amount of money he will need for disbursements during a certain period. Likewise, in order to meet these necessary disbursements, he will apply against them his possible receipts. On account of the better commercial standing and conveniences afforded by the acceptance, the seller is able to calculate as nearly as possible the amount of money he will require, much more efficiently than is possible under the open account method. As a result, it would eliminate the necessity of borrowing in excess.

ACCEPTANCE ESTABLISHES EVIDENCE OF COMPLETED TRANSACTION

The trade acceptance in the hands of the seller, in place of the open book account furnishes the best evidence of a completed transaction in merchandising, and places the burden of proving the correctness of the details connected with the transaction upon the buyer. It enables the seller effectively to disprove of the possible necessity of subsequent proof of the legal status of the transaction.

Trade acceptances exhibit for inspection the highest class of accounts. The necessity of accepting a seller's draft drawn upon the buyer will cause the latter to make every possible investigation of the correctness of the transaction beforehand, which will diminish to a great extent any inconvenience, as frequently arises under the open book account system.

ACCEPTANCE EFFECTS ECONOMY IN TIME AND EXPENSE

The business houses and banks which have used the acceptance and have studied its advantages from every angle, testify to the fact that it is the least expensive of all other forms of settlement, from a standpoint of economy in time and expense, and as regards cost of collections, handling of accounts, accounting and general recording. The seller, when he receives the acceptance from the buyer treats the draft as a settlement of the open book account and transforms it into a liquid asset with negotiable value.

THE ACCEPTANCE AS A MEANS OF GAUGING MORE ACCURATELY THE CREDIT STANDING OF THE BUYER

The use of the acceptance enables the seller to gauge more accurately the credit standing and paying habits of the buyer. Under the open book account system of settling accounts, the buyer generally allows his accounts to lag over past maturity, to the disadvantage of the seller. Furthermore, the open book account system frequently gives rise to discrepancies in the transactions, as a result of which the buyer must at times forego his reputation of established credit and good business conduct. By this is meant that the open book account

method is productive of errors interfering with the conduct and business relations of the parties. The acceptance affords the seller a means of learning the paying habits of the buyer, and of how the buyer meets his obligations.

ACCEPTANCE STRENGTHENS THE SELLER'S FINANCIAL STANDING

In a preceding topic there were discussed the advantages of the acceptance to the seller from a standpoint of liquidity in assets. This advantage is further extended in the judgment of the seller's financial standing. Judging the financial standing of any seller of merchandise, the bank considers accounts receivable as worth only a share of the amount represented. The seller, presenting his financial statement to his bank, will be regarded in a more favorable light if he is a user of acceptances than if he conducts his business on the basis of the open account or on single name paper, as acceptances are looked upon by banks with more favor.

ACCEPTANCES ENABLE SELLER TO OFFER BANK BETTER COMMERCIAL PAPER

Trade acceptances are regarded by the Federal Reserve Board as more advantageous for banking business than are single name and other commercial paper. Single name paper is not as preferable to the banker as the trade acceptance, since in the former, one party is liable, while in the latter, the banker may have recourse to two parties who are jointly liable. For this reason, banks are inclined to give better rates in the discount of trade acceptances, and also, because of the fact that they themselves are allowed better rediscount rates by the Federal Reserve Banks in the discount of trade acceptances.

ACCEPTANCES NO INTERFERENCE TO SELLER OR BUYER IN SALES

When a deal is consummated between seller and buyer, it may be that certain terms have been arranged upon which the carrying out of the contract might be wholly dependent. The seller may not have arranged to receive cash payment from the buyer and the buyer may

not be able to pay any cash for his purchases. The seller, through the acceptance, is enabled to assist the buyer in carrying out his original intentions without the latter being forced to pay, as the burden of financing the buyer is passed along to the bank.

The purpose behind the establishment of a discount market in the United States is to collect the available reserves and funds of the nation to be loaned out and used in the process of absorbing commercial paper and principally acceptances. It is through this last mentioned method that the seller may avail himself of the use of the funds which the bankers are able to collect, for the benefit of the buyer as well as for himself.

ACCEPTANCE ENABLES SELLER TO ASSIST CUSTOMERS BY EXTENSION OF CREDIT WITHOUT OBLIGATION ON FORMER

Modern day transactions are based entirely upon credit. It has been estimated that ninety per cent. of the country's business is done upon a credit business, that is, by the giving of something having a present value for a promise of payment in the future. The seller is restricted through his limited capital to grant any too great an amount of credit to any one class of buyers. Neither does the seller wish to forego the opportunities of materializing on possible sales.

Furthermore, the buyer is equally anxious to do business with the seller, if he can procure the merchandise on a credit basis. The acceptance, therefore, provides a means whereby the buyer may take advantage of a bargain to the equal advantage of the seller—a process which can be carried out only with the coöperation of the banker, who has at his command the available funds which may be used for this purpose.

The above described advantages accruing to the seller from the employment of the acceptance would alone be worthy of the time and attention of business men. Not only in the above way is the acceptance of value, for the benefits which may flow from its continued use are even more extensive and numerous than those mentioned above.

CHAPTER X

THE BANKER AND THE TRADE ACCEPTANCE

The Duty of the Banker

It is a matter of common knowledge that in periods of great prosperity, credits are apt to become over extended, both in amounts and as to length of time. This is due to the fact that in times of prosperity, business is conducted at a considerable volume of profit. Furthermore, business men lose sight of the fact that nearly all periods of prosperity are sooner or later followed by periods of business depression. The result is that business houses find themselves with their business and profits greatly reduced and their credit obligations reaching the maximum.

In times like these money becomes scarce, as a result of which accounts are made difficult to settle, bringing about failures in business, to the great loss of all the people of the country.

As a remedy to the above conditions, the trade acceptance method is advocated, to the end that it will eliminate credit over-extension with its accompanying evils.

It is, therefore, to the banker that the problem of improving credit conditions and curtailing over-extension falls. The banker is especially interested in acceptances, and there are a number of interesting reasons why the average banker should encourage their use.

THE ELEMENT OF RISK

Without question, from a consideration of the previous discussions of the trade acceptance, and from the standpoint of both the buyer and seller, the banker gains a great advantage from this class of commercial or two name paper, for it gives him a better opportunity of measuring risks than under the open book account system. Under the open account method, the best that could be done was to estimate the risk. Under the trade acceptance method the risk can be actually measured.

HIGHER COMMERCIAL STANDING OF ACCEPTANCES

When a depositor seeks to borrow money on single name paper as security, the banker is never sure as to the purpose of its origin. The

borrower may desire the funds for the purpose of using them in the general conduct of his business, but the banker knows nothing about the actual transaction against which he is extending credit.

The banker knows that the trade acceptance represents a current transaction. It shows on its face the reason why the credit is extended. The trade acceptance arises from a merchandise transaction and is backed up by the merchandise which it covers as security for its payment. The trade acceptance is consequently of a higher commercial standing than single name paper or paper with no uniformity of purpose in its origin, as commercial paper used by the Government banks for the issuance of bank notes it acts as a form of special currency.

ACCEPTANCE REQUIRES LESS CREDIT RE-EXTENSION

Borrowers very frequently seek to have their bankers extend the time within which to meet their single name notes. Frequently, they are obliged to make new loans in order that they may be enabled to take up maturing notes. In this connection, a general refunding process is necessary. The banker, moreover, in discounting single name paper, takes it for granted that he may sooner or later be called upon to extend the date of maturity.

In the discount of trade acceptances, however, the banker knows that the particular transaction is segregated from the borrower's general business, and that the obligation arises from a tangible nature. He knows furthermore that it will be actually liquidated at a definite date. He knows also that the trade acceptance may only arise from transactions involving the sale of merchandise, and there is something of a tangible nature from which the obligation can be met.

SELF LIQUIDITY OF TRADE ACCEPTANCES

The banker, in lending money on single name paper has no concrete idea as to where the depositor is going to get the money to meet the note when due.

In the discount of trade acceptances, he knows that certain goods have been shipped to the acceptor and that through the sale of these goods during the period that the trade acceptance is outstanding, the acceptor expects to get the money with which to meet the trade acceptance at maturity.

REDISCOUNT PRIVILIGES OF THE BANKER

Under the provisions of the Federal Reserve Act, the banker is privileged to rediscount trade acceptance with the Federal Reserve Bank of his district. Dealings in trade acceptances and their use are highly encourag-

ed by the Federal Reserve Board as well as by the various Federal Reserve Banks, and preferential rates are granted for their rediscount. Trade acceptances have been taken from the mass of general commercial paper and have been placed in a class by themselves. Their credit standing is much higher than other forms of commercial paper, and they command a better rate of discount than single name commercial paper. The margin of profit in the process of rediscounting trade acceptances is to the advantage of the banker also, for he is enabled, generally, to take advantage of the leeway in rediscount rates which are generally a fraction of a percent lower than the discount rate charged by the bank to the customers.

The creation and development of discount companies in the United States is progressing at a rapid rate, and the time is doubtlessly not far distant when these discount companies will be able to render a very important service to banks and bankers. Discount companies prefer trade acceptances to single name paper and would much sooner purchase them from bankers than they would any other class of commercial credit instruments. Such discount companies would also doubtlessly offer more favorable rediscount terms than the Federal Reserve Banks, being especially organized for the particular purpose of commercial paper and acceptance dealings.

LIMITATIONS AS TO DISCOUNT OF COMMERCIAL PAPER FOR ANY ONE PARTY NOT APPLICABLE TO TRADE ACCEPTANCES

Banks are generally restricted from lending to any one individual, person, firm or corporation in an amount in excess of ten percent of their capital and surplus, either upon promissory notes or single name paper, even when such security is of the best sort. This has proven to be a wise legal provision and has prevented many over-extensions of credit.

However, there have been occasional instances where people who have been entirely worthy of additional credit for seasonal requirements, have been unable to obtain the same from their bank, and consequently, the bank in some cases has lost a good part of the business of one of its most valuable customers.

The above restrictions are not imposed upon banks in the discount of trade acceptances. The bank, therefore, may discount for its customers their acceptances in excess of the ten percent limit. Customers, the credit of which are good, may then be taken care of by the bank in the proper way.

ASSISTANCE TO BANKS IN CREDIT MATTERS

Trade acceptances necessitate collections upon maturity, which work is invariably done by banks. Where they are generally used, bankers are in a position to keep in very close touch with local credit conditions, and have an opportunity to observe which of the local people pay their acceptances promptly and satisfactorily, and which of the local people meet their obligations in an unsatisfactory way. At the present time the local banker has only a general idea as to how various peoples in the community settle their open accounts. Under the acceptance system, he will know definitely the credit standing of the various people of the community in a more certain way.

PREVENTION OF ASSIGNMENT OF BOOK ACCOUNTS

It frequently happens that open book accounts are secretly assigned, the knowledge of which might remain unknown to the banker. Such assignments of accounts are sometimes made by very reputable people in order to overcome real disadvantages existing in our present system of extending credit. The assignment of accounts is a menace to sound credit conditions, as one's assets may be transferred without the knowledge of those whose interest it is to know it.

The holder of acceptances will be able to realize upon them at short notice, instead of being forced to either wait until the accounts mature or to loan thereon, at greater cost.

The trade acceptance would overcome in a legitimate manner all such disadvantages for it would eliminate the practice of secret assignment of accounts.

ASSISTANCE IN JUDGING CUSTOMERS

In the discount of trade acceptances by a depositor, the banker is able to learn which of his customers are desirable and which are unsafe or dangerous. Trade acceptances enable the banker to judge his depositors' customers as either comprising a good or bad class. The advice of the banker would doubtlessly lead the depositor to concentrate his efforts on the good customer and discontinue business with such as the banker might suggest were unsafe. This will tend to eliminate losses on the part of the depositor.

In judging the basis for credit of a particular party or firm, bankers

generally expect that the total bills and accounts payable will not exceed fifty percent of its quick assets, consisting of cash, accounts receivable and inventory. It is believed by some bankers that the introduction of the trade acceptance would interfere with this so-called fifty percent rule, as a bank would then be called upon to continue the process of discounting for any one customer for the full value of the acceptance, in other words, treating the acceptance as the equivalent of quick assets.

In European countries, where the acceptance method is most developed, bankers make a distinction in extending credit on acceptances and on open accounts. They allow the depositors two lines of credit, one against trade acceptances, and the other based on inventories. The banker examines the trade acceptances offered, and if he finds them of a high-class nature, extends a liberal line of credit. The banker then carefully considers the exact nature of the inventory and its status with respect to existing liabilities and grants a line of credit based on the inventory, depending upon whether the products are staple or not readily saleable.

Foreign bankers claim that this is a more scientific way of extending credit than our method of merely granting fifty percent, and furthermore, it is pointed out by these foreign bankers, that they loan money on two specific items in their depositor's statement. First, they discount the trade acceptances, which represent the best form of accounts receivable, and second, they loan money on the depositor's inventory considered in relation to the depositor's liabilities. Under this system, the money advanced by the banker is very seldom used for the purchase of machinery, extension of buildings and for acquiring other fixed assets, as is sometimes the case under our system where the banker does not make such close inquiry as to just what the money is to be used for. Credit extended on trade acceptances is based upon money due to the depositor, while straight bank loans are based upon inventories.

THE ACCEPTANCE AS A BASIS OF A LIQUID CURRENCY

It is to the bankers' great advantage that credit conditions always remain sound throughout the country, as this is the basis for sound finance. In our system of note-issues by the Federal Reserve Banks, the security is of two classes, the first being gold, and the second commercial paper of recognized standing. On account of their high commercial character acceptances are included in the class of commercial paper taken as security for note-issues. The banker is consequently able to use his acceptances to obtain Federal Reserve Notes. In other words, acceptances are as good

as cash to the banker. It would, therefore, seem that every banker should be interested in constantly improving the quality of commercial paper used as a basis for the issuance of these notes.

ACCEPTANCE CREATES MORE BUSINESS FOR BANKS

It is doubtlessly true that trade acceptances would create a larger volume of bankable paper and as a result a larger volume of business for the banker. Businessmen would allow more of their transactions to pass through the bank, such as collections, discounts, rediscounts, affording a better means of employing their funds, and a consequent benefit of wider banking activity.

ACCEPTANCE BENEFITS LOCAL COMMUNITY WHEREBY BANK IS DIRECTLY BENEFITED

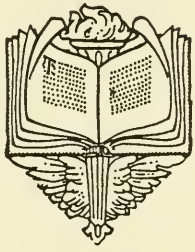
Local manufacturers and jobbers have experienced at times great difficulty in the course of their business, either through inability to secure sufficient working capital or in the high rates of interest exacted by the local banks. The use of trade acceptances will enable the banks to employ their resources safely and will permit them to encourage the local manufacturers and jobbers in the safe and reasonable expansion of their business, thus aiding in the economic and business development of their locality. The banker moreover will be more inclined to discount trade acceptances bearing at least two names, in preference to single name paper, and will generally allow a lower rate for discounting than on other classes of commercial paper. In this way a more regular system of earnings with less loss may be established to the benefit of the banker.

THE ACCEPTANCE ACTS AS AN ECONOMIZER OF TIME AND EXPENSE

It has been stated by a number of people questioning the acceptance as a saver of time and lost motion, that bookkeeping would be greatly increased by the use of acceptances. This is not so, for the banker himself knows that the amount of work involved in the clearing of checks could not be increased through the handling of trade acceptances. Furthermore, two name papers, because of its better security, will reduce losses to the bank.

THE BANKER CONSIDERED FROM THE STANDPOINT OF INVESTMENTS IN ACCEPTANCES

As an investment, the banker is benefited both directly and indirectly. He is able to utilize his spare funds, thereby making them productive. He is able to obtain short loans from the Federal Reserve Bank of his district on his own acceptances while not being required to rediscount them. He is able to deal with banks and brokers direct in the distribution of commercial paper, to his benefit.



CHAPTER XI

THE CONSUMER, THE RETAILER AND THE TRADE ACCEPTANCE

The Financing of Time Payment Sales

In recent years, there has been developed a system of financing especially designed to assist the retailer and principally the consumer in time payment sales.

This is accomplished by means of the so-called retail trade acceptance. In some lines of retailing, where the sale amounts to more than the average sum, and beyond the immediate means of the consumer, the merchant sooner or later finds that he can carry on many more times the amount of business conducted by him if he could extend credit, instead of sell on a basis of cash-payments. Unfortunately, the majority of consumers, in making purchases of high priced articles, are not disposed, nor have they the means, to pay cash beforehand. They would rather make periodical settlements. The merchant, however, cannot afford to sell numerous consumers on open account as he would soon find himself limited in his activities.

PRACTICAL WORKING OF THE PLAN

The practical working of the "retail trade acceptance" method of financing time payment sales is as follows: Let us suppose that a manufacturer or dealer desires to sell his products to the consumer, direct. The products above referred to may be articles of household utility.

First, the manufacturer or dealer, after completing arrangements with the so-called "acceptance corporation" or the "commercial bank" operating the plan, instructs his salesmen and clerks in all the details of the operations. Folders and other literature for their instruction, also advertising for the public, are then prepared for publicity purposes so that all factors in the transaction will understand it clearly.

The next step is for each dealer who desires to avail himself of the plan to get in touch with the so-called "acceptance corporation" or the "commercial bank."

The dealer is required to give to the bank or to the "acceptance corporation" a financial statement, upon which basis he is granted a certain line of credit, which means that he can turn over acceptances to the bank or to the acceptance corporation until he has reached the maximum established for him. These details being settled and the contract signed, the dealer is furnished with all the necessary blanks and forms. The forms consist of a "retail trade acceptance" and a "conditional sale agreement," which, upon having the signature of the consumer, or purchaser affixed thereto, evidences a lien on the goods sold, title to which does not pass to the purchaser-consumer until the entire amount of the acceptance is paid by him.

The dealer is then prepared to handle his time-payment or credit accounts on this plan. Dealers usually embody a statement to this effect in their advertising or by suitable signs. An example illustrating the operation of the plan follows:

Assume that a customer wants to purchase an article from a dealer and pay for it in deferred payments, extending over a period of one year. We will assume that the article sells for $150 and that the dealer requires 20% down. In addition to the $30 cash payment, the customer is required to pay at the same time, 6% discount on the $120 trade acceptance, which represents his obligation, and 1% of the selling price of the article, or $1.50, as fire insurance for one year for the article purchased. The dealer is required to pay a service fee of 2% of the face value of the acceptance or $2.40 to the acceptance corporation.

The transaction works out in figures, thus:

Selling price of article	$150.00
Payment down 20%	30.00
Balance	$120.00

Customer gives his trade acceptance for $120.

The customer has twelve months within which to pay the sum of $120, that is $10 per month.

The customer pays in cash	$30.00
Six per cent. discount on the $120 trade acceptance for twelve months	7.20
Insurance, 1% of selling price	1.50
Total cash paid by customer	$38.70

Dealer receives from customer as above	$38.70
From the acceptance corporation or the bank, the face value of the trade acceptance, $120, less discount $7.20, and insurance $1.50; or $8.70	111.30
Total	$150.00
Dealer pays 2% of acceptance as service fee	2.40
Dealer receives net	$147.60

From the above, it will be noted that the dealer receives $147.60 for the article, which is $2.40 less than the cash selling price, the difference representing the bank's charge to the dealer for the service. Through this arrangement the dealer obtains cash for the sale of the article and he steps out of the transaction at once.

Should the customer fail to pay, the dealer is contingently liable. The dealer, therefore, is required as a matter of protection, to investigate his customer's credit before making a sale of a product, or he may request the bank sponsoring the plan to do it.

The dealer requires the customer to sign the conditional sale agreement which is attached to the trade acceptance. He, then draws the trade acceptance for $120 on his customer, and his customer accepts it by writing his name across its face.

Thereupon, the dealer indorses the trade acceptance and takes or sends it to the bank or to the "acceptance corporation" with which he deals, in exchange for which he is paid the face value of the acceptance, less the charges as aforesaid.

Subsequently, the "acceptance corporation" or the bank sends a letter to the customer giving the details of the transaction in order that the customer may check it up, and at the same time the bank encloses a coupon book which must be used in making payments at the bank. The days of the month on which payments are to be made are stated clearly in the coupon book, and the customer is required to make his payments as they fall due monthly, at the bank of "acceptance corporation," or through special arrangements, payments may be received by the dealer to be turned over immediately to the bank.

MANUFACTURER OR DEALER CONSIDERED

This is only one of many ways in which the acceptance may be employed. However looked upon, whether it benefits most the manufac-

turer, or the dealer, the consumer, or the bank, is a matter of opinion. It might be said, however, that as regards the manufacturer or dealer, the retail trade acceptance permits the marketing of their products without tieing up their capital, and in this way, they are able to lower the price of the merchandise, at the same time being enabled to increase their sales. They have little to lose by the operation of the plan. They receive money for the sale immediately, whereas the consumer is not required to pay for the same in full until a much later date.

THE BANK OR ACCEPTANCE CORPORATION CONSIDERED

The advantage to the bank or "acceptance corporation" handling the transaction may be judged from the example above given. The only element of risk involved lies in the credit ability of the dealer or manufacturer, but as this is investigated beforehand, the bank enters into the transaction with assurance that its client is reasonably able to back up the risk. The transaction is a profitable one for it and the fields for development are unlimited. The total charges paid above the discount amount are moderate, considering the convenience the plan affords to the dealer and customer.

CUSTOMER CONSIDERED

As to the customer, it might be said that the advantage he gains is immediate possession of the merchandise without having to pay the purchase price at once, while the charges upon a percentage basis are very low when considered quantitatively. And, it must be considered that the consumer has one year's time within which to settle entirely. The discount of six percent for the period of one year is deducted beforehand. The extra charge of one percent is, therefore, the only one, which may be regarded as reasonable for the convenience which the plan affords.

CHAPTER XII

MISCELLANEOUS POINTS OF ADVANTAGE TO USERS OF THE TRADE ACCEPTANCE PLAN

Credit Investigation Always Necessary

Credit of Parties to the Bill Should Always be Investigated

Proper investigation of the credit standing of the parties to the acceptance is just as necessary in the acceptance method as when goods are sold on open account. The responsibility of the acceptor as well as of the drawer should always be ascertained. In discounting trade acceptances for their customers, banks may suit themselves as to the requirement of a statement from the acceptor. However, in the case of an unusual amount of acceptances being discounted, the bank should procure sufficient information in order to enable it to determine whether the acceptor is of good moral and financial standing and whether he is capable of meeting his obligations upon maturity.

TRADE ACCEPTANCES INTENDED FOR CURRENT TRANSACTIONS ONLY

Trade Acceptance Should Represent Current Transactions Only

The trade acceptance has a specific function to perform, and should be used for one purpose only, that is, as a negotiable acknowledgment of an actual sale of goods from a seller to a buyer. It covers a live transaction, drawn for the time involved in the terms of the sale. In order to maintain their high commercial standing, acceptances should not be used for any other purpose but that involving present merchandise transactions. Overdue accounts should not give rise to acceptances in any event.

RENEWALS SHOULD NOT BE ENCOURAGED

Under normal conditions, a trade acceptance should not be renewed, since it no longer represents a current transaction. Acceptances should always be paid at maturity. Instances have been observed where

it was expected that a trade acceptance would be renewed from time to time on the plea that sales by the drawer to the acceptor were occurring each month, aggregating or exceeding the amount of the trade acceptance. This is not good practice. The acceptance should be drawn for a period corresponding to the sale, and wherever possible, for the actual amount due on the particular sale, or accumulation of sales. The exception to this latter statement takes place when it is necessary to issue acceptances in smaller pieces to facilitate their discount.

ACCEPTANCE DOES NOT IMPLY THE GRANTING OF LONGER TERM CREDITS

The giving of trade acceptances should not be used as an excuse for obtaining unreasonable time in sales terms. Many firms desiring to introduce the trade acceptance plan in financing their business have adopted the plan of granting additional time or longer term credits to their customers. While many firms have in this way successfully introduced the acceptance, others believe that undue inducements in the form of extension of time and of discounts, in order to convert accounts into the liquid form of trade acceptances, will tend to cheapen the calibre of the acceptance.

ACCEPTANCE SHOULD BE INTRODUCED TO ALL ALIKE

Many concerns have adopted the acceptance in the case of customers who have proved themselves to be slow payers. While there is no objection to this method itself, still if the concern attempts to market or discount these acceptances and makes claim to a preferential rate because of the two name self-liquidating character of the paper, it would not be doing the acceptance method full justice and would not allow the full benefits which may accrue from it.

Moreover, when one considers that the trade acceptance method serves to show the bank the character of buyers to whom the borrower is selling, and whether or not these buyers pay promptly, the bank receiving for discount from its customer acceptances of companies of inferior credit standing and slow-paying reputation will not become very enthusiastic about making a preferential rate, but may even feel like revising upward the loaning terms to that customer. A company which uses the acceptance for reforming its slow-paying accounts should not market such acceptances or discount them as first-class paper for this tends to cheapen the trade acceptance movement.

GUARDING AGAINST FRAUDULENT ACCEPTANCES

As in every line of activity the good are mingled with the bad, so in the trade acceptance is there a danger of fraudulent commercial paper arising. Just the same as the banks have to contend with difficulties arising from fraudulent drawings of checks, in the same way is it possible that acceptances representing fictitious transactions should be created. Banks should exercise great precaution and should extend their credit watchfulness by every possible means to prevent forgery and fictitiousness.

PUBLICITY IN ACCEPTANCE SHOULD BE EXTENDED LIBERALLY

To those firms which seek to adopt the trade acceptance plan, it might be said that publicity from the start with full explanation and education should be given to the buyer on the subject of the trade acceptance and its advantages to him. No arbitrary action should be forced upon the buyer, but on the other hand, a general outline of the principles of the acceptance method should at all times be the means of inducing the buyer to adopt it as a legitimate means of financing his purchases.

CHAPTER XIII

The Legal Phase of the Acceptance

It has frequently been asked whether a trade acceptance payable at a certain bank operates in the same manner as does a check; that is to say, if a trade acceptance is presented at the bank where it is made payable, for payment, is the bank obligated in the same way as it is on a check drawn upon it by one of its depositors.

Prior to the enactment of the Negotiable Instruments Law, there was a conflict of opinion in the different States on this point. Where a customer made his note payable at a bank, some States, as New York and Pennsylvania, held that it was equivalent to a check. In other words, the acceptance operated as an order upon the bank to pay; and on presentation at maturity, it was paid and charged up in the same manner as a check would be.

Courts in other States, however, held that it was not equivalent to an order to pay, and that a note payable at a bank simply designated the bank as the place of payment, and the bank, as the customer's agent, had no authority by reason of that clause in the note, to make payment at maturity without his express instructions. Such a condition exists in the Negotiable Instruments Law to-day in the case of instruments presented after the date of maturity, when it becomes necessary to procure the express instructions of the maker before payment is made thereon.

THE NEGOTIABLE INSTRUMENTS LAW AND ITS RELATION TO THE ACCEPTANCE

The Negotiable Instruments Law which has been enacted in every State of the Union, except Georgia and Texas, contains a provision which clears up this conflict of authority by the enactment of the clause which provides that where an instrument is payable at a bank, it is equivalent to an order to the bank to pay for the account of the principal debtor thereof.

However, in four or five States, this particular section is eliminated, by which it may be inferred that the legislators intended not to have it prevail. Illinois, Nebraska and South Dakota omit this section. In Missouri, by an amendment made in 1909, an addition was made to the end of the section as follows: "But where the instrument is made payable at a fixed or determinable future time, the order of the bank is limited to the date of maturity only." That addition was intended to clear up the question, when a note payable at a bank was not presented on the precise day of maturity, whether the bank had authority to make payment without instructions from the maker. In Minnesota, the word "not" is interpolated so as to read "and as not equivalent to an order." In Kansas, however, the section quoted has been stricken from the law by a subsequent amendment. In other words, in Illinois, Nebraska, South Dakota, Minnesota and Kansas, there is no authority or right for a bank to charge up a note or trade acceptance which is made payable at a bank, without express instructions from the acceptor. In all other States, excepting Texas and Georgia, where the Negotiable Instruments Law is not in force, an acceptance made payable at a certain bank is equivalent to an order upon that bank to pay.

Acceptances being negotiable instruments, that body of law which governs negotiable commercial paper is applicable to them. (For Negotiable Instruments Law, refer to Part V).

A REVIEW OF PRACTICAL QUESTIONS AND ANSWERS ON THE TRADE ACCEPTANCE METHOD

(1) Q. What is meant by the trade acceptance system?

A. By the trade acceptance system is meant the substitution of time drafts drawn by the seller on the buyer of merchandise at the time of sale, for the present system of "open book accounts."

(2) Q. What is a trade acceptance?

A. A trade acceptance is a negotiable certificate of indebtedness arising out of a current transaction in merchandise, having a certain

maturity, drawn by a seller on a buyer, for a fixed or determinable sum of money, representing the purchase price of goods. A trade acceptance is payable to order and bears across its face the unqualified and unconditional acceptance of the buyer.

(3) Q. What is the purpose of the trade acceptance?

A. The primary purpose of the trade acceptance is to express a credit obligation arising from the sale of goods.

(4) Q. What is the general advantage of the trade acceptance?

A. It makes possible a fuller utilization of the commercial credit of the country than is possible under existing methods.

(5) Q. What is the distinction between the trade acceptance and the promissory note?

A. The trade acceptance is confined to transactions involving the sale of goods. The promissory note may cover practically any kind of obligation.

(6) Q. What is the distinction between the trade acceptance and the draft?

A. The trade acceptance is confined to credit obligations arising from the sale of goods and must have a definite maturity. A draft may cover various kinds of transactions, may be payable on demand or at sight or at the end of a stated time. (For forms of trade acceptances in use, see Part IV).

(7) Q. What is objectionable to the "open book account" system?

A. (a) It provides an easy method for the abuse of credit by buyers who allow their accounts to remain unpaid for unreasonable periods, without payment of interest.

(b) Assets in the form of "book accounts" remain illiquid, and are, therefore, not a good basis for credit.

(c) The "open book account" system interferes with the sale of goods, in that it creates the possibility of an argument on the subject of the credit period.

(d) It unnessarily ties up an unreasonable amount of the value of the merchandise involved.

(e) It ties up the seller's capital without a stated compensation to him.

(f) It necessitates costly collections, extensions of time in payment, trade discounts and abuse of sales terms.

(g) It forces the seller to perform a banking function for the buyer.

(h) It tends to raise prices, this being the only way in which the seller can protect himself against the burdens forced upon him.

(8) Q. Name the chief objections to single name paper?

A. (a) It is not usually as strong as two name paper, because, in the latter case, two parties instead of one are responsible.

(b) It is not so readily negotiable as the trade acceptance and is not conceded so favorable a rediscount rate.

(9) Q. What are the disadvantages of "single name" paper in the hands of the banker?

A. All national banks and many State banks are strictly limited by law as to the amount of loans they may make to any one borrower. This restriction does not exist in the case of the discount of "two name paper" representing a current business transaction, such as trade acceptances. The limitations applied to single name paper are required by prudent banking, but where there are obligations of many different buyers with the indorsement of the seller, such limitation is not essential or desirable.

(9) Q. May the trade acceptance be used for any purpose other than to express a credit obligation arising from the sale of goods?

A. This may be answered in the negative.

On the above question, authorities are in substantial agreement that efforts to employ the trade acceptance for any other purpose is certain to cause confusion concerning the value of the trade acceptance.

(10) Q. Describe the business practice involved in a merchandise transaction in which the trade acceptance is used.

A. First, by a consummation of the bargain between the seller and the buyer of goods, a definite amount due, with a definite term of payment is agreed upon.

Second, the seller then draws an acceptance on the buyer and presents it to the latter.

Third, if the buyer is willing to assume that title to the goods has passed to him, that the conditions of the sale have been complied with and that the drawing of the acceptance upon him is in proper form, he may accept by writing across the face of the instrument the word "accepted," with the date, place of payment and his name following, and return this acceptance to the seller or to the bank presenting it.

Fourth, the seller may either hold the acceptance until maturity or may arrange to have it negotiated. The seller may also have the acceptance discounted with a bank, thereby obtaining available funds and preventing a tie-up of his capital.

Fifth, when the acceptance matures, the acceptor may either pay it or may secure an extension of time. This may be accomplished by treating the acceptance as a past due obligation and covering it by a promissory note. However, in cases like these, a prior understanding on the part of both buyer and seller is necessary.

Sixth, if the acceptance has been discounted at a bank, the bank may have the acceptance rediscounted with its Federal Reserve Bank, thereby being assured of liquidity in its investments.

(11) Q. What are the advantages of the trade acceptance in the hands of the banker?

A. The legitimate acceptance of the successful dealer, discounted by the seller at his bank, is the most liquid kind of paper obtainable. In the event of any sudden withdrawal of deposits, or any unforeseen stringency, such paper in the hands of the banker is immediately available to meet such withdrawals, or may be used to acquire additional loans by the process of rediscounting.

Single name paper, however, has been regarded heretofore as undesirable for rediscount, and lending banks have usually required the direct obligations of borrowing banks which the latter were adverse to giving, since the appearance of "bills payable" in a bank's statement has for a long time been looked upon by the public as elements of weakness; the lending powers of banks were necessarily limited, by reason of the necessity of holding the notes of their borrowers until paid.

(12) Q. (a) Why should a seller prefer a trade acceptance, instead of a note, from the buyer?

(b) Why should a buyer who can purchase on "open book account" on liberal terms give an acceptance?

A. (a) The trade acceptance is, on its face, an instrument representing a particular sale of goods, and an absolute acknowledgment of the correctness of the seller's claim as well as a definite promise to pay on a day certain. If the acceptance bears the clause prescribed by the Federal Reserve Board, "The obligation of the acceptor hereof arises out of the purchase of goods from the drawer," it is prime commercial paper rediscountable at Federal Reserve Banks at a lower rate than other commercial paper.

Therefore, every seller who has trade acceptances in his hands, instead of open accounts on his books, puts himself in a position to be treated more liberally by his bank, and secondly, is enabled to handle additional business, or if required, to "carry" a customer who is temporarily embarrassed, or to tide over a season of reduced volume of business.

(b) The buyer who is not in a position to take cash discounts will be better able to compete with the cash buyer.

The trade acceptance, showing on its face that the obligation is made for a purchase of goods, the transaction establishes rather than reflects on the acceptor's credit.

By giving a negotiable evidence of indebtedness to the seller, the buyer shows his good faith and by meeting his obligations, improves his credit. The fact that with every purchase he makes a definite promise to pay on a day certain, will train him to be a more careful and intelligent buyer.

(13) Q. How may a seller introduce the trade acceptance method?

A. (a) By making a conditional sale, that is, requiring "trade acceptances" as the terms of sale.

(b) By writing an explanatory letter and following it up by a trade acceptance.

(c) By writing a short explanatory note of a few lines on a perforated section above or below the acceptance, explaining its operation.

("For publicity on the acceptance method," examine forms contained in Part IV).

(14) Q. To what extent may the acceptance method be employed?

A. In all transactions calling for credit extension, beginning with

the manufacturer who purchases from the first producer, to the ultimate consumer who purchases from the retailer.

(15) Q. What are some advantages which the buyer derives from the trade acceptance method?

A. (a) It develops careful buying on the part of the buyer.

(b) It strengthens his credit and puts him in the position of a preferred buyer.

(c) It develops in him the habit of prompt payment and furnishes him with an excellent excuse for requiring prompt payment from his customers.

(d) It enables him to keep better tract of his outstanding obligations, thereby avoiding the evils of over-extension of credit.

(e) It enables him to realize that credit is as tangible as cash and should be regarded and used accordingly.

(f) It eliminates wastage and lost motion attending the open book account method.

(g) It releases business capital for new transactions.

(h) It improves the chances of the buyer of small means to operate in successful competition with the larger buyers.

(i) It helps the buyer by making him deal always in current transactions, rather than in long, drawn out book accounts.

(j) As the buyer often becomes the seller, the same advantages that apply to the seller apply to him.

(k) It serves as a tonic to the business organizations concerned.

(l) It prevents the accumulation of overdue accounts, and above all, develops a sounder and more serious attitude towards the buyer's own obligations, which is indeed of most benefit to him. It acts therefore, in the capacity of a governor, regulating and protecting the credit of the acceptor.

(16) Q. What are the advantages which the seller derives from the acceptance method?

A. (a) It relieves him from the burden of financing his customers and the consequent burdening of his own capital.

(b) It enables him to conduct business on a more systematic basis with a more regular income schedule.

(c) It puts the burden of proving correctness of the details of the merchandise transaction where it belongs, upon the buyer.

(d) It provides the seller with a liquid asset.

(e) It reduces the expenses of collection.

(f) It simplifies the process by making it a detail in banking machinery.

(g) It promotes the economical treatment of merchandise and enables the seller to do business at a smaller operating cost.

(h) It relieves him from the necessity of selling his accounts at a high rate of interest usually exacted.

(i) It enables him to offer the bank additional security.

(j) It strengthens the seller's financial statement by showing the character of his accounts.

(k) It enables the seller to gauge more accurately the commercial standing of the buyer.

(l) It tends to confine borrowing to funds actually needed.

(m) The seller inoffensively assists the buyer to complete his contract in the way in which he originally intended to complete it.

(n) It enables the seller to more accurately calculate his collections for stated periods.

(o) It enables the seller to facilitate his customer's business by the extension of credit and by deliveries in a way not always possible under the open account system.

(p) It gives to the seller two name paper to present to his bank for discount.

(q) It enables the seller effectively to dispose of the possible necessity of subsequent proof of the legal status of the transaction and to exhibit for inspection the highest possible class of book accounts.

(17) Q. What are the advantages which the banker derives from the trade acceptance method?

A. (a) It enables the banker to measure his risks more accurately.

(b) It provides the banker with substantial evidence of the soundness of the stratum of credit underlying the banking business.

(c) It increases the availability of assets.

(d) It creates a secondary reserve.

(e) It enables the banker to borrow more easily than heretofore, because the trade acceptance can be so easily rediscounted at the Federal Reserve Bank.

(f) It increases the customers' credit and borrowing possibilities.

(g) It creates better commercial paper and a better class of accounts.

(h) It enables the bank to judge whether its customers and its customers' customers are following sound business methods.

(i) It increases the amount of bankable paper on the market by directing to the bank financing functions, now performed by manufacturers, wholesalers, jobbers and others.

(18) Q. What are the advantages of the trade acceptance system to business in general?

A. (a) It improves trade relations between buyer and seller, by clearly defining their respective obligations. It releases funds otherwise tied up in open book accounts, and by substituting readily commercial paper for non-negotiable book accounts, it makes capital more fluid.

(b) It provides a check against carelessness and extravagance, by reminding the debtor constantly that his credit may be put to the test.

(c) It enables invested capital to do considerably more than its present volume of work, with less risk.

(d) It lowers borrowing rates because of the production of standard paper and because of the elimination of unnecessary risks, and further, because the Federal Reserve Board offers preferential discount rates for this class of paper.

(19) Q. What are some of the evils which the trade acceptance would remedy?

A. (a) The practice of taking unearned and unauthorized discounts, the prevention of losses by bad debts, and the evils attendant upon the carrying of overdue accounts.

(b) The prevention of secret assignment of book accounts.

(c) The prevention of the practice of canceling orders and returning goods without sufficient reason.

(d) The prevention of overbuying and overselling.

(20) Q. Does the trade acceptance eliminate the promissory note?

A. No. The promissory note deals with all kinds of business transactions; the trade acceptance with current merchandise transactions only. The trade acceptance is not to be given for borrowed money or past due obligations.

(21) Q. What is the effect of trade acceptances upon credit?

A. The trade acceptance method does not change the term of the credit—it simply carries the credit in better form. The merchant whose statements show "acceptances payable" and "acceptances receivable" should be entitled to a higher credit rating than one whose statements show "accounts payable" and "accounts receivable." The merchant who brings his transaction out into the open and serves notice upon the business world that he is willing to meet his obligations at maturity, is a better business risk, and hence, entitled to better treatment than one who has his accounts carried upon an indefinite and unbusiness like arrangement, as is prevalent in the open account method.

PROCEDURE

(22) Q. Where is a trade acceptance payable?

A. Ordinarily, at the buyer's bank, or at some other place mutually agreed upon at the time of its issue.

(23) Q. By whom is the trade acceptance presented for discount?

A. Ordinarily, by the seller of merchandise.

(24) Q. May the buyer present a trade acceptance for discount instead of the seller?

A. Yes, if agreeable to the seller, and if there is a reason for so doing. This is frequently done when it is possible for a buyer to procure a better discount rate from his bank than the seller could secure from his.

(25) Q. Can the acceptance be legally treated as a check chargeable against the buyer's balance at his bank without further instructions or authority?

A. This may be answered in the affirmative. The Negotiable Instruments Act provides that "Where the instrument is made payable at a bank, it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon." Express authority or instructions from the bank's depositor, the acceptor, is not required in the opinion of some authorities, assuming of course, that the acceptor has on deposit with the bank sufficient funds for the purpose.

THE FEDERAL RESERVE AND ACCEPTANCES

(27) Q. What is the attitude of the Federal Reserve Board towards acceptances?

A. The Federal Reserve Board has expressed its unqualified approval of the acceptance method, by selecting it from the class of commercial paper and giving to it a regular credit standing. It has seen fit to establish preferential discount rates to encourage their use, as it believes that in this way could be made possible the maintenance of a highly elastic credit system.

(28) Q. What are the advantages offered by the Federal Reserve System as an inducement to the use of trade acceptances?

A. (a) The system offers extensive rediscount facilities with preferential rates.

(b) The banks are not restricted in their loans and purchases of acceptances as in the case of single name paper, to any one person or concern.

(29) Q. What is eligibility, and what are the requirements of eligibility as applied to trade acceptances?

A. By eligibility is meant the quality of the acceptance which the Federal Reserve Bank will rediscount. In order that an acceptance should be eligible,

1. The obligation must have arisen out of an actual commercial transaction, domestic or foreign;

2. It must have a maturity at the time of purchase of not more than ninety days, exclusive of days of grace;

3. It must be indorsed by a member bank or supported by a satisfactory statement of the financial condition of one or more of the parties thereto.

(30) Q. What are the requirements by Federal Reserve banks as to evidence of eligibility?

A. (a) The acceptance must present prima facie evidence of eligibility.

(b) It must bear a stamp, or certificate, affixed by the acceptor or drawer showing that it is a trade acceptance.

CHAPTER XIV

Methods of Introducing the Acceptance

Method of direct appeal; buyer must be shown, not forced.—The Institute has received many letters from firms engaged in nearly all lines of business, manufacturing, wholesaling and retailing, outlining the methods adopted by them for the purpose of introducing the trade acceptance in their business. One firm which has resorted very largely to the trade acceptance method of financing its business, writes:

"The most successful way we have found of introducing the acceptance method among our customers was for us to make a direct appeal at the necessary time to them, as for instance, upon the sending of an invoice for goods sold, and, at that time drawing a distinction between the open account method and the acceptance, and outlining the advantages of the latter to them."

The following letters and explanatory matter are used by a number of large houses which have successfully introduced the acceptance method.

Extending the use of acceptances through salesmen.—The principles of the acceptance and its general adaptability to any business requiring credit extension have been extended by a number of firms through salesmen travelling for them. Salesmen are generally instructed as to the necessary procedure and are given full advice as to the advantages of the acceptance method in comparison with the open account.

Undoubtedly, personal contact with the customer could be made a most desirable form of introducing the acceptance. The salesman, in negotiating with the buyer, first points out the advantages of the acceptance to the latter, and then makes the sale and granting of credit conditional upon the buyer giving his written acknowledgment of his indebtedness in the form of a trade acceptance. If the buyer, for some reason or other, should decline to give his acceptance, it is unwise that he be in any way forced, as experience has shown that time and a more carefully prepared program of publicity will eventually make him see the merits of the plan.

Other methods used by some commercial firms have been in the form of publicity through house organs and so-called trade and merchandise circulars. Therein are outlined the various ways of settling for merchandise, and the general utility of the acceptance. Explanatory letters and notes attached to bills and statements at the time they are sent to customers have also been productive of good results. One house uses the plan of showing the saving to the buyer by giving his acceptance. (See Forms Part IV.) It is assumed naturally that preferences are extended to those buyers consenting to give their acceptance.

Still another way in which some houses have succeeded in introducing the acceptance has been to bring home to the buyer the advantages of the method to him through plain facts and figures attractively stated. The one contained in this chapter "Fair Play in Business" and similar ones, with the same purpose in view, are also used by a number of concerns with success.

It would be well for those desiring to use the acceptance method with greater success to consider the buyer on open account and on the acceptance method. Those houses which have adopted the plan of financing their business through the use of the trade acceptance have generally had to extend some consideration to the buyer willing to give his acceptance in preference to the one desiring the open account. As the seller of merchandise is benefited greatly in using the acceptance method through having his accounts in liquid form, he could very well afford to give a better consideration to his buyer. This consideration may be in the form of a larger discount than allowed buyers on open account. Some houses prefer to give more consideration to the buyer by means of granting him a longer term of credit, that is, a longer time within which to meet the acceptance. Other houses give a credit larger in amount than the buyer on open account is allowed, mainly for the reason that accounts are thereby kept in liquid shape and may be realized upon with comparative ease. As to whether the buyer giving acceptances should receive merchandise at a lower figure than those purchasing on open account is a question to be decided by the firm from the nature of its business and the circumstances which are involved in their sale.

But to all of the above, it might be said that the giving of any consideration, however small, is still unnecessary on the part of the seller. The buyer benefits as well as the seller and it is to the advantage of both to favor and extend the plan.

Publicity Methods in the Use of Acceptances

Form of Slip Attached to Trade Acceptance Forwarded to Buyer

This plan of attaching an explanatory slip to the acceptance at the time it is sent to the customer has proved to be productive of good results.

A TRADE ACCEPTANCE

is an acknowledgment of a debt by the buyer in favor of the seller, for merchandise that the seller has placed in the hands of the buyer. The buyer agrees, in writing across the face of this acceptance his name, the name and location of his own bank and the date, to pay the amount of this certain indebtedness at a certain time at his own bank.

This varies from the open book account method only in giving the debt a negotiable value.

According to a *FEDERAL RESERVE BANK GOVERNOR'S OPINION, the signing of an Acceptance increases the financial standing of the giver,* because it shows prompt paying methods.

Kindly, sign attached Acceptance, then forward to us.

Explanatory letters attached to trade acceptances by some firms, which letters are detached when the acceptances are signed. (Sample of attached letter):

By recent ruling of the Federal Reserve Bank, we are enabled through the medium of trade acceptances to grant the special terms you requested on the accompanying invoice. If you will sign and return this acceptance, you will place us in a position to discount this paper at our bank, placing the burden of carrying the account on them.

This varies from the open account only in giving the bill a negotiable value and involves absolutely no additional obligation on your part.

According to a **Federal Bank Governor's Opinion,** the signing of an acceptance increases the financial standing of the giver, because it shows prompt paying methods.

If you prefer to take advantage of the 2% cash discount, you may return this acceptance unsigned, with your check within thirty days from the date of invoice. Otherwise, kindly sign the attached acceptance, then forward to .....of.....

Following is another form of sample letter used as an explanation of the acceptance when sending invoice and acceptance to the buyer.

TRADE ACCEPTANCES FOR BETTER BUSINESS

The Trade Acceptance is a negotiable certificate of indebtedness arising out of a current transaction in merchandise.

The Trade Acceptance covers the purchase price of the merchandise and is payable at a stated time and place.

The Trade Acceptance is the highest type of commercial paper. It cannot be given for a loan or past due account.

The Trade Acceptance stands for fair exchange between buyer and seller. The buyer gives a negotiable receipt for a shipment of equal value.

The Trade Acceptance emphasizes the good faith of the acceptor. It indicates that his obligation has been wisely contracted and is to be met when due.

The Trade Acceptance is, of course, understood by the banker, for he knows that as purchases are made debts are incurred and that when such liabilities are shown as "Trade Acceptances Payable" instead of "Accounts Payable," there is convincing evidence of the acceptor's conservative business methods.

We offer special "Acceptance Discounts" to customers closing their time accounts with trade acceptances.

ANOTHER FORM OF EXPLANATORY LETTER USED WITH SUCCESS.

The new **Federal Reserve Banking Act** provides for discounting "trade acceptances" at minimum rates. These are drafts drawn by seller and accepted by purchaser, and bearing evidence that the draft represents an actual delivery of goods.

All other great nations have long possessed this system, the lack of which has been a prominent cause of the monetary stringencies which often afflict the United States, and now that our government has adopted the plan, it is not only a financial advantage but a civic duty for American business houses to forward it.

Taking advantage, for our mutual benefit, of this provision of the Federal Reserve Act, we are able to offer you, instead of the terms stated on the enclosed bill, special terms for **accepted draft, in attached form.**

If you wish to avail yourself thereof, please accept the enclosed draft by signing and filling in the name of your bank in the spaces provided, across the face of the draft, and return it to us promptly in

settlement of the enclosed invoice. Otherwise, terms will remain as stated on the face of the invoice.

To conform to requirements, this acceptance must be returned immediately upon receipt of invoice.

FAIR PLAY
BETWEEN
THE BUYER ↔ THE SELLER

GIVES:—

THE SELLER an order for certain goods.
THE SELLER a promise to pay according to terms of sale.
THE SELLER an opportunity to dispose of his goods.

HAS:—

THE SELLER'S goods in his place of business.
His profit from the sale of THE SELLER'S goods.
The use of his profit and of THE SELLER'S capital.

GIVES:—

THE BUYER the goods he has ordered.
THE BUYER an agreement to allow payment on terms other than cash.
THE BUYER an opportunity to sell his goods at a profit to himself.

HAS:—

The account entered on his ledgers.
His capital and profit tied up until the expiration of credit term.
An asset which is not available in its present form.

IS THIS FAIR PLAY?

THE TRADE ACCEPTANCE OFFERS

THE BUYER:

The means of assuring himself of a continuous source of supply.
A protection against financial disturbances—attended by higher prices.
An opportunity to open and close an account in one operation.
The means of keeping closer tab on his obligations and establishing a broader credit standing.

THE SELLER:

The means of continuing to supply the buyer's needs at the lowest prices and on the most favorable terms.
A protection against unforseen difficulty in financing shipments to the buyer.
The opportunity to realize on his accounts at minimum expense.
The opportunity to devote more of his time and attention to meeting the buyer's requirements.

Quicker Turnovers—Prompter Pay—Surer Profits

The trade acceptance is made out in accordance with regular terms of sale, running over the same credit period and for the same amount as the invoice. It is simply a negotiable promise to do exactly as the buyer agreed to do when the goods were ordered—every buyer should be willing to back his word with his signature.

THE TRADE ACCEPTANCE OFFERS TO BOTH BUYER AND SELLER THE MEANS of introducing economy and efficiency into business and its use will place this Country on a par with foreign countries in the great struggle for after-war trade.

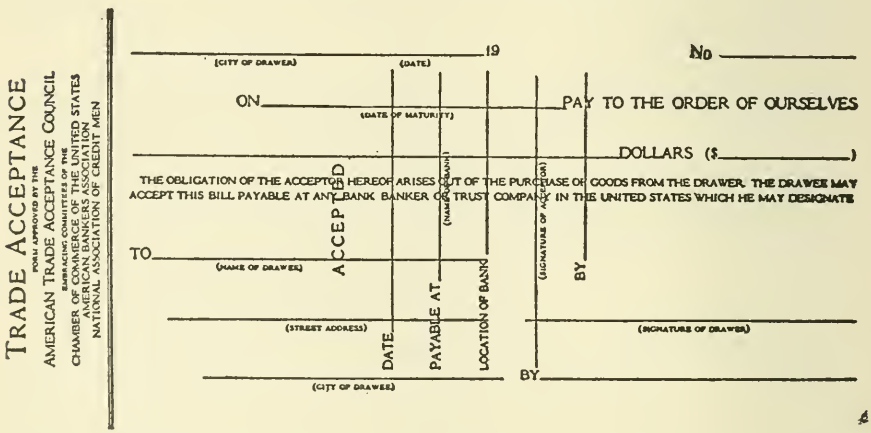
METHODS OF A BROOKLYN BANK

The First National Bank in Brooklyn is effectively promoting the use of trade acceptances through advertising. An advertisement recently published by it contained an illustration of the trade acceptance form, and pointed out that—

"A trade acceptance saves the transmission of cash and enables the creditor not only to arrange the definite date of payment with the debtor but, if necessary, to secure the use of a sum practically the equivalent of the debt long before that debt is due in the ordinary course of business."

Through the advertisement, the bank invited further inquiries in response to which its vice-president, William S. Irish, sent one or more letters, these presenting not only an explanation of what trade acceptances are and how they are used, but a strong argument for their adoption by both sellers and buyers.

GETTING YOUR MONEY BEFORE IT IS DUE



A trade acceptance saves the transmission of cash and enables the creditor not only to arrange the definite date of payment with the

debtor, but, if necessary, to secure the use of a sum practically the equivalent of the debt long before the debt is due in the ordinary course of business.

Ask for full information concerning this better method of financing sales of merchandise.

FIRST NATIONAL BANK IN BROOKLYN
Broadway and Havemeyer Streets

Another form of letter used by the same bank to encourage the use of acceptances:

FIRST NATIONAL BANK
IN BROOKLYN

DEAR SIR:—

At this time when every dollar of cash and credit counts in speeding up production the trade acceptance makes capital more effective.

Many of our customers have been bringing trade acceptances to us for discount which have been given by customers of theirs in payment of merchandise. They tell us that they find this method very satisfactory for themselves and for their customers.

We believe that in order to get all the advantages of trade acceptances their use should become general, but in order to accomplish this it necessarily becomes a give and take proposition.

Won't you therefore, when asked by your customers to give acceptances, kindly give them, for in so doing you will greatly encourage this up-to-date-method of financing business.

Thanking you for your coöperation, we are,

Very respectfully,

(Signed) WILLIAM S. IRISH,
Vice-President.

Another form of publicity used by this bank follows:

FIRST NATIONAL BANK
IN BROOKLYN

DEAR SIR:—

There are many advantages in the use of the trade acceptance, a specimen of which is enclosed herewith.

For example, suppose you are a wholesaler and in selling goods to a customer on credit, instead of charging the purchase against him on your books, it is agreed between you that you draw a bill on him for the proper amount, payable in 30, 60 or 90 days.

When "accepted" by the buyer (that is, when he signs his name in the blank provided for it across the end of the draft) the bill becomes

a "trade acceptance" and may be discounted at your bank, which, if it is a member of the Federal Reserve System, may rediscount it with the Federal Reserve Bank.

Thus, an account that ordinarily would have to be carried on your ledger until maturity is converted into "commercial paper" which, in turn, may be converted into cash.

The First National Bank wants to assist all it can in the development of the trade acceptance plan at this time. We feel that it is not only a profitable method, but also a patriotic service for every business man to conduct his business transactions in such a manner as will keep his resources available for immediate use, when our country must employ all possible capital and credit.

We should be very glad to explain to you more fully just how trade acceptances will help you, whether you are a buyer or a seller.

Yours truly,
(Signed) WILLIAM S. IRISH,
Vice-President.

CHAPTER XV

Progress in the Acceptance Method

FOR AND AGAINST

Expressions and Opinions

From the Leading Commercial and Financial Organizations, the Government, the Bankers and Specialists on the Acceptance Method

Herewith are reviewed the opinions and expressions of some of the leading commercial and financial organizations, the Government, bankers and specialists on the acceptance method, qualified to speak upon the subject.

Also, there are given extracts from some of the leading articles on acceptances, as well as extracts from the speeches of the leading proponents of the acceptance method.

These may be taken as conclusive evidence of the practicability of the acceptance from those who have studied it from every angle and who have proved to themselves that it is far better than any credit system that has ever been devised.

It has been estimated by the leading credit associations of the country that at the present time more than ten thousand firms and business establishments are users of the acceptance in one form or another.

The American Acceptance Council, an organization especially existing for the furtherance of the acceptance method, estimates that there are more than that number of users.

Nationwide investigations conducted in the interests of better business for the country show that in those cases where the acceptance has been put to the test, rarely has it failed to supply the desired results.

Not only is the acceptance of benefit to its present users, but it holds out equal advantages for the country's business in general. True

it is that the acceptance method is not intended to eliminate all other forms of banking credit, for, in some lines of business, its use would be to confuse existing methods rather than to aid them. The acceptance is not intended as a substitution for all prior methods. It is, on the other hand, an improvement in credit methods.

If the acceptance could save for the merchant but a small fraction of a per cent. of the annual turnovers in business, in costly account carrying, in frozen liquid accounts, tied up and awaiting settlement, in tied up capital, in lost motion, in extra expense of conducting business, in bad debts, in slow collections and other evils; if it could be the means of an open discount market capable of absorbing the commercial paper produced by the country's business, thereby creating liquidity in the nation's resources, and be a means of extending financial equilibrium at all times, with the cheapening of money and its advantages to business,—can we not say that the acceptance is a national asset—a means of conserving the national resources?

Let us see what the following say:

FROM THE GOVERNMENT

The following interesting letter was received from Governor W. P. G. Harding of the Federal Reserve Board by the American Acceptance Council, and expresses clearly the attitude of that highest of financial tribunals in the country towards the trade acceptance method:

"TO THE AMERICAN ACCEPTANCE COUNCIL, NEW YORK:

"The Board is advised by letter from your Executive Secretary, dated October 22nd, that the American Acceptance Council, organized to encourage the use of bankers' and trade acceptances, is at this time conducting a campaign in the interests of trade acceptances.

"Your activities in this connection are observed by the Board with satisfaction. It is a matter of public knowledge, justified by frequent and emphatic expressions from the Board, that the purposes of the Federal Reserve Act would in many cases be better served by the general adoption of trade acceptances in lieu of book accounts and 'one name' paper. The acceptance has the added security of a second name, it usually evidences upon its face that it represents a commercial, industrial or agricultural transaction, and gives reasonable assurance that it will be liquidated at maturity by proceeds from the sale of the identical goods involved. For these reasons, the Board believes that this class of credit instrument is often more desirable than single name paper as an investment for the funds of the Federal Reserve banks,

and has backed this belief by authorizing a preferential rate for trade acceptances.

"There are, of course, some branches and kinds of business which are not adaptable to the use of trade acceptances, and the question of such adaptability must be left to the judgment of those interested. The Board does not undertake to urge the use of the trade acceptance against the wishes of interested parties, but merely takes the view that the trade acceptance represents generally a convenient and scientific kind of credit instrument and has no hesitancy in recommending that it be utilized wherever practicable.

"Very truly yours,
"(Signed) W. P. G. HARDING,
"Governor."

FROM THE COMMERCIAL, FINANCIAL AND CREDIT ORGANIZATIONS

At the 24th annual convention of The National Association of Credit Men, held in Detroit, on June 10th to 13th, 1919, the following resolutions were recommended in a report presented by its Committee on Banking and Currency:

"*Resolved,* That the National Association of Credit Men hereby reaffirms the action of former conventions in approving the principles of the trade acceptances as a desirable credit instrument for the ordinary commercial transactions of the nation, believing that the trade acceptance is superior to the open book account, that it is a logical development of the Federal Reserve Act in the emphasis and dignity it gives to commercial paper as a national asset, and that it will tend to decrease trade abuses, give greater liquidity to capital, and therefore should be known and used generally in mercantile credits.

"*Resolved,* That in the approval given by this convention to the trade acceptance, it is earnestly recommended that in the literature of the National Association and local associations, and in the activities of succeeding committees, this be the attitude taken—that wherever the trade acceptance is found adaptable and can be used to advantage by the credit grantor, he be encouraged to use it without restraint or criticism; that those who do not find it adaptable or of economic advantage at this time in their credit transactions be not required to use it; the convention believing that such attitude will permit the subject to receive study and consideration without any rancor and those insinuations that would impeach the intelligence of one either favorably or unfavorably inclined toward the instrument."

FROM THE AMERICAN BANKERS COMMITTEE ON ACCEPTANCES

The list of known users of the Trade Acceptance has grown rapidly, having increased over four thousand in the period of one year. It in-

cludes practically every line of industry and all sections of the United States. Out of the reports received not one single valid objection has been presented where proper use of the Trade Acceptance has been undertaken. In every legitimate case the instrument is praised most highly. Experience has actually demonstrated that the use of the Trade Acceptance enables an equal amount of capital to do a greater amount of service. It has also enabled its users to reduce their bills payable account, to buy a greater amount of Treasury Bills and to handle without difficulty the increasing volume of their business with the attending high prices, to shorten the credit period, to reduce the number of claims and disputes, to afford a definite check-up on all transactions, and to generally stabilize their business—producing at the same time a great volume of liquid paper, eligible for rediscount at the Federal Reserve banks and for service as the basis of currency issue.

The following paragraphs are taken from the recommendation of the Chamber of Commerce of the State of New York, one of the oldest organizations of the kind in existence and noted for the sound and conservative quality of its judgment, on the Trade Acceptance:

"A new step of importance to the development of the Federal Reserve System will be the adoption by merchants of the method of settling accounts by Trade Acceptances. Your Committee desires to give its approval to the principle involved in this method of settling accounts between sellers and buyers. It believes that merchants throughout the country should be encouraged in every way to study the question of Trade Acceptances and to bring the matter to the attention of their customers. The introduction of new methods of business of this description requires time and patience, in order that those adopting them may become thoroughly familiar with their methods and with the benefits to be derived therefrom."

FROM PROPONENTS OF THE ACCEPTANCE METHOD

Paul M. Warburg, chairman of the Executive Committee of the American Acceptance Council, made the following statement of principles relative to trade acceptances at the first meeting of the Executive Committee of the Council on April 14th, 1919:

"We are preaching the gospel of the trade acceptance for no other purpose than that we believe its use makes for sounder business and banking conditions.

"We do not say that single name paper is not good, or illiquid; but we may fairly say that the trade acceptance is better and more liquid.

"We do not say that the trade acceptance serves all purposes and that all cash sales and all cash discounts ought to be avoided; but we do say that where business is not done on a strictly cash basis, the trade acceptance will be found the safer, sounder, and in the long run, more economical method than the open accounts.

"Indeed we believe that it is so much of an improvement over the open account that in some cases sellers, at present sacrificing a very heavy cash discount for the purpose of avoiding the dangers and inconveniences of open accounts, might find it to their advantage to consider the economy involved in the use of the trade acceptance when dealing with customers of strong credit.

"We do not want to appear as wishing to force upon anybody the adoption of the trade acceptance, unless he considers it as serving his better interest. We do wish, however, those who can profit from the method to study it carefully and not to hesitate to adopt it.

"The American Acceptance Council's interest in the matter is that whatever makes for better morals in business and for better credit and banking conditions is a decided benefit to the United States."

In the banker the acceptance should find an enthusiastic friend. From purely business considerations its merit should appeal to him powerfully. To him and his interests—its general use would mean a better business tone, higher business morality, safer business risks, sounder assets, cleaner commercial paper, greater liquidity, a broader scope of usefulness, and the diverting to the bank of profitable business functions which logically belong there, but which at present, under the antiquated and inequitable open-book account method of treating credits, are performed by the seller of merchandise not only without profit, but to his distinct disadvantage.

The business man who now sells upon open-book account, and who suffers from the injustice which follows its use by his customers, should hail with delight the relief suggested in the coming of the acceptance. None can realize as he the awkwardness and even danger of trade burdens which had their origin in bad business practice and which find their only justification in the sorry fact that business weakly allows itself to tolerate them. Why the manufacturer or dealer will allow his perfectly good capital to be tied up in frozen book accounts for unreasonable periods of time, determined by the whim of the buyer, when in the use of the trade acceptance there is suggested a means whereby each transaction virtually will finance itself, and be paid definitely at maturity, is a thing difficult to reconcile with the conceded cleverness of the American business man.

It is difficult to understand, too, why this class of business men should tolerate open-book account evils in the form of indefiniteness, overdue obligations, bad debt and interest losses, disturbance of profit calculations, collection annoyances and expense, and the rest of a long

list of undesirables—when every proper protection for their credit interests is provided in the acceptance method.

The interest of the buyer of merchandise in the acceptance, although perhaps less clearly apparent than that of banker and seller, nevertheless is a substantial one, particularly in view of the fact that in the series of commercial processes which extends from production to consumption, every buyer but the last is a seller, and every seller but the first a buyer. In this way every buyer except the ultimate consumer buys that he may sell, and hence in his attitude toward the acceptance both points of view must be included. (From an address by Mr. Lewis E. Pierson, President of the Irving National Bank).

D. C. Wills, Chairman, Federal Reserve Bank of Cleveland, says:

"Trade acceptances automatically furnish that highest class of credit data, namely accurate information, enabling bankers to estimate more intelligently the responsibility of their borrowers. A high grade trade acceptance will find a wide market.

"Every time a trade acceptance is substituted for a promissory note based on the mixed and undefined credit of the maker or for a book credit of still more ambiguous character, a step has been taken toward the ideal of sound trade credit."

A TRADE ACCEPTANCE REVIEW

By Robert H. Bean

Executive Secretary American Acceptance Council

The elevation of acceptance credits to a position second only to cash is an accomplishment of the first year of the new era in American business methods following the world war. The necessity of a change from the time-worn open account system of settling for merchandise purchased on credit has been recognized for several years. A preliminary agitation and discussion to bring this about has been carried on with special emphasis during the past twelve months by industrial and financial organizations throughout the country.

Trade and bankers acceptances are an established fact in the operation of our domestic and foreign trade. No change of whatever merit in our system of business or finance has ever or will take place without opposition. The arguments of early opponents to this system, based as they were on the idea that the old methods were good enough, have been long since met by sounder logic founded on the analysis of modern day needs, and the proponents of such arguments have steadily decreased in numbers.

The custom of selling merchandise on time and carrying the charges on open account had been so long in vogue that many did not recognize the merit of a system that would release for other purposes the more than four billion dollars tied up in frozen, illiquid open account credits. Far-seeing and open-minded students of the commercial and financial needs of the new America, however, recognized at a date closely following the action of the Federal Reserve Board that in the fullest development ofthis economically sound system of finance lay tremendous possibilities. The very small number of users of acceptances from 1915 to 1917 has increased to many thousands, made up of merchandising concerns in all parts of the country.

The basic principle underlying the use of the acceptance method of settling accounts is that it will bring about the improvement of the credit position of the individual, corporation, community and nation. That such a condition is the goal of business men and bankers throughout the world should be acknowledged without question. Next to the cash discount system it commands the highest regard, and, contrary to the impression of some, the trade acceptance method need not interfere in the slightest with the system of paying cash within a stated period and taking a discount for it.

It is not claimed by the proponents of the acceptance method that acceptances can be used with equal facility in every kind of business. In fact, it is admitted that it may not be to advantage of some kinds of business to use this system, but it is claimed that for a very large part of the commercial interests of this country the acceptance system can be used with remarkable success. It is not a cure-all for every defect in the nation's credit machinery. There is no mystery about a trade acceptance, neither is there any magic by which a bad account will be made good or relieve the necessity for continued careful scrutiny of credits by the credit departments of business houses and banks. It is simply an acknowledgment of a debt and its execution reflects credit upon the buyer as well as the seller and is the evidence of a well-organized, carefully managed business.

The American Acceptance Council has found that the acceptance method of financing is now used to some extent in practically every kind of business where goods are sold outright and where sales terms are other than cash. Many national associations of wholesalers and retailers have endorsed the system and have recommended its use by members. The American Bankers Association at its last convention reaffirmed its stand on acceptances and provided for the appointment of committees composed of business men and bankers who are to make a study of the entire question, work out a system of handling acceptances in banks and business houses, and to determine upon a reasonable charge for collection, exchange and service by banks to which these items pass for payment.

The volume of bankers acceptances has increased with each succeeding month, and remarkable headway has been made in the estab-

lishment of an open discount market in this country similar to that which has been in existence in England and the continent for generations.

As the bankers in smaller cities realize the investment possibilities of this class of paper, there will be a greater desire on their part to familiarize themselves not only with the bills offered for purchase but the circumstances surrounding their creation and the rates which they demand.

There is nothing temporarily or transitory about the acceptance system. It has been carefully studied by our financiers for several years, and that it fits in with our plan of readjustment after the extraordinary conditions through which we have passed is the combined thought of the ablest minds in our financial and industrial affairs.

The remarkable success in developing trade and industry in England and other European countries may be laid to the policy followed by bankers and business men in those countries to seek out and apply those principles which work for the greatest benefit to the commerce of the country rather than to that plan which will yield in dollars the greatest immediate return.

The demand which we face at this time is for the fullest use of our resources, and this can best be done by releasing a greater amount, if possible, of illiquid and tied up credits.

From reports gathered throughout this past year by the American Acceptance Council, it is safe to say that the progress thus far made, and the promise of still greater development in the use and operation of trade and bankers acceptances, augur well for the future prosperity of the commerce of this country.

THE OTHER SIDE OF THE QUESTION

In order to present both sides of the question on the use of trade acceptances, the following letter written by the assistant treasurer of a large manufacturing company in the United States is given. It should not be construed that the acceptance method is impracticable for similar lines of business, as the letter merely expresses a viewpoint as to its limitations. The last paragraph contained in this letter tells the story. However, it has been found in the past, and bankers and large business houses have testified to the fact, that it is the larger corporations, the resources of which are tremendous and which do not require borrowing, doing business on practically a cash basis, that find very little use for the trade acceptance. These large corporations do not care to give any trade acceptances for they virtually control the situation. In a letter received by the Institute, another manufac-

turing firm states that it is due to these larger corporations that the acceptance method, which is conceded by the highest commercial and financial interests of the country to be of most good, is retarded in its development. This firm states that activities directed to the development of the acceptance method should start with these firms first.

As you know, we are definitely committed to the granting of an unusually large cash discount. Our 5 per cent. cash discount, which is a part of our terms for all branches of our line, is equalled only by the cash discount granted on a few special lines in the garment field. You are familiar with the reasons for the granting of this unusually large cash discount. Since we are dealing largely with merchants of limited capital, we do everything that we can to make a man turn his capital often.

The primary purpose of the trade acceptance movement is to expand the credit structure of the nation. Of course this expansion does not in any way increase the actual amount of wealth. What we strive to do with our long cash discount is to make a man turn his capital frequently and it follows that every time that he turns his capital and makes a profit it is producing wealth.

From the standpoint of the national interest in the present emergency, it has been held by a dozen or more of the country's largest bankers, to whom our particular problem has been submitted in detail, that we serve the country better by making our customers' dollars work overtime than we would by deferring payments and lengthening terms, in accordance with the trade acceptance plan.

Looking at this question from a standpoint solely of the interests of the ..... Company, there are several things to be considered: First of all, the acceptance plan has been devised to assist the man whose results in handling open accounts have been just average, or less than average. It so happens that our results, over a period of years, have been very much better than the average. Our accounts receivable are not uncertain; our losses are negligible; our cash discount terms are enforced in all of our dealings with all of our customers. If we are to put into operation a system, which is planned to bring up the man who has been getting poor results to a level where he can expect average returns, we actually will have to bring ourselves down to a lower level than that upon which we have been doing business. This is just a matter of mathematics. We are not taking credit to ourselves, because our collection results have been exceptionally good (we know that they can be better), but we do not care to lose any of our "punch" merely because a lot of other fellows have slow accounts and cannot enforce cash discount terms.

If we were to make a general use of trade acceptances, we probably could discount those acceptances and in this way borrow money at a figure slightly under the current market rate for single name paper.

At the same time, if we did this we would be merely borrowing money on the name of ..... Company, so far as most of the acceptances might be concerned, because we have very few customers whose names on the pieces of commercial paper would mean anything as a basis for borrowing from our banks in New York, Philadelphia, Boston, or Chicago.

Furthermore, it would be necessary to create a special department to handle these acceptances. The maintenance of such a department would represent a considerable item of expense. It would also be necessary to set up and to keep up a reserve to pay discounted acceptances which our customers did not meet when they came due. The interest on this reserve alone would more than eat up the slight saving in the cost of borrowed money secured on acceptances.

It must be borne in mind also, that if we were to use acceptances regularly throughout the year, we would face a necessary lengthening of our terms. We could not profitably arrange to discount and rediscount customers' paper which would run for less than 60 days. This would react directly upon the Credit Department, because, instead of being in a position to shut off upon a man when he did not take advantage of his cash discount for a single month's purchases, our cash discount would be eliminated and we would have no excuse for shutting off deliveries until a man failed to meet his first acceptance at the end of 60, or possibly even 90 days.

The credit men also would face the problem of handling customers who would give acceptances, sincerely believing that these acceptances represented cash and actually paid their accounts. For example, a dealer, with a credit limit of $5,000 would order $5,000 worth of goods from us, under the dating proposition, in January and would give us an acceptance for $5,000 when the goods were delivered. It would be a very difficult thing for us to convince that dealer that by giving us his name on a piece of paper he had not actually paid his bill. If he were to give us an acceptance, it would be nothing more than natural for him to expect to come right in to order and receive another $5,000 worth of goods on open account. Of course the acceptance would merely serve as a basis for borrowing and the transaction would produce no money except such money as the ..... Company would borrow and pay for. The customer's account would not be settled until the acceptance cleared at his bank on the due date. If, after taking his $5,000 acceptance we were to give him another $5,000 worth of goods on open account, we merely would be doubling his limit without any sort of security.

From the standpoint of the ..... Company alone, therefore, the use of the trade acceptance would involve additional operating detail and additional expense, with an actual slowing up of our collection methods and an increase in risks.

From the standpoint of the salesmen in the field, the trade acceptance is a mean thing to handle, because at the time he takes the

order the salesman is compelling the buyer to think definitely and specifically about paying the bill. The chances are if an order is taken for a thousand dollars and then the salesman asks the customer to sign an acceptance for a thousand dollars, that in many cases the customer will wish to be on the safe side of things and will actually cut down the amount of the order placed with us. Further, if we are to place upon the salesman in the field the burden of explaining a trade acceptance plan to customers, we are going to make it necessary for him to spend a good part of his time selling this part of the program to customers—the time which might otherwise be devoted directly to producing orders.

When the proposition is viewed from the standpoint of the customer, there is just one question to be asked and answered. Why should any customer who has regularly discounted his bills, give to the ..... Company a trade acceptance, unless conditions have so changed that we actually need that customer's assistance in financing his purchases through a dating period? When we ask the customer for an acceptance, we give him nothing in return for it—it is just an additional consideration that he is showing us. If we are dealing with customers who live up to the contracts that they make and if we see to it that they do live up to these contracts, the acceptance would give to the customer nothing that he does not already have, and, as many customers will persist in viewing it, would be merely requiring the customer to give some form of "security" as a guarantee that he will pay his bills when he says he will. If a customer always has maintained a clean discount record with us it would be a little bit hard for him to figure out why we should require, at the present time from him, more than we have in the past.

We believe that the trade acceptance is an excellent thing for the concern of limited capital doing business with established corporations, whose names on acceptances will be a direct addition to the borrowing power of the people to whom the acceptances are given. We believe in acceptances for houses selling goods on very long terms to customers who are not in the habit of paying promptly, also for houses that have found open accounts to be "a very uncertain thing" and for those houses who experience great difficulty in enforcing cash discount terms.

CHAPTER XVI

IMPORTANCE OF THE ACCEPTANCE TO THE NATIONAL INTEREST

Modernization of the Credit Structure

The high quality of the bank and trade acceptance as commercial paper has induced the Federal Reserve Board to adopt and use it as a sort of special currency. The extension of government credit is effected on the basis of gold and the highest class commercial paper denominated as bank and trade acceptances. As gold is not present in sufficient quantity —dollar for dollar—to meet the tremendous sums of money required for the conduct of the nation's business, it becomes necessary, in order that the currency and credit of the country may be kept in a most liquid state, that some substitute measuring up to the qualities of gold itself, be used. The acceptance, as high class commercial paper possessing the qualities required by the Board, is, therefore, of great importance to the maintenance of an ideal credit system. The acceptance modernizes the country's credit structure, and it is for this purpose that bankers and business men should encourage their use in every way.

LIQUIDITY OF THE NATION'S RESOURES MADE POSSIBLE BY THE EXTENSION OF THE ACCEPTANCE METHOD

The desire on the part of commercial and financial interests of the country, as well as the government itself, is towards maintaining the resources of the nation in a most liquid state. The present system of open book accounts, in this respect, is unwise, since it ties up tremendous amounts of capital and renders it unproductive of wealth.

Today, in the country's credit situation, there is a vast army of credit awaiting to be mobilized for the purpose of upbuilding our resources, but so long as we keep it in the form of book accounts, it is being unnecessarily chained, fettered and useless, from being utilized to the greatest extent. The releasing of the tremendous sums of money which otherwise lie dormant and unproductive would do more towards mobilizing the national

resources than any other means of credit extension. In other words, the general adoption of the acceptance and its application to the credit system of the country would increase the business capital of the nation.

ADVANTAGES TO THE BUYER, SELLER AND BANKER, EQUALLY ADVANTAGEOUS TO THE NATIONAL INTEREST

It is equally true that the advantages which flow from the wider use of the acceptance in this country, benefiting alike the buyer, the seller, the banker and the consumer, are equally advantageous to the nation's welfare.

THE ACCEPTANCE AS A FACTOR IN NATIONAL PREPAREDNESS

At the present time, with the continuous call for efficiency methods, and the general adoption of those plans through which the aims of the government for utilizing the entire national resources to the fullest extent may be made possible, the more systematic operation of credit and its extension should be equally the aim of the entire business world. The national interest demands that the maximum of efficiency be introduced. Public interest is best subserved by better and more conservative business methods, by the elimination of wasteful methods of conducting business, and by improved trade relations and harmony among the commercial and financial world.

WELFARE OF NATION LINKED WITH ITS CREDIT SYSTEM

Credit is the life blood of business. The welfare of the nation demands that the credit system should at all times be at the height of efficiency. The development of sounder credit methods is not only important and urgent, but indispensable. Therefore, any methods having as their goal the bettering of business methods should receive the whole-hearted co-operation of the banker, the business man and the nation.

THE ACCEPTANCE IN THE FIELD OF COMMERCIAL CREDIT

The acceptance method is of great importance to the national interest. To the soundness of the nation's financial system, it is necessary that commercial credit be kept in such a condition of fluidity and usability that to the fullest possible extent it will serve as an unshakeable foundation for all times.

BANK

ACCEPTANCES

Their History, Practical Uses, Operation under the Federal Reserve Act, Advantages, Eligibility, Discounts, Markets, Discount Corporations, Dollar Credits, Investments, etc., etc.

CHAPTER XVII

Bank Acceptances

There has previously been discussed the nature and functions of credit, particularly as they relate to commercial credit and its instruments. There have also been considered the various classes of credit such as are availed of by individuals, firms, business enterprises, and Governments. However, by the banks there is created what is known as banking credit, which arises in a way similar to that of commercial credit.

BANKING CREDIT

Banking credit is the power of a bank to secure advances of funds in exchange for its promises to pay. In this respect, it is related very closely to commercial credit, the only difference being that in the former case, the bank is the source of credit instead of a business establishment. Banks in this respect are manufactories of credit.

The credit of a bank is extended by means of the bank check, the bank note, the bank draft, and the newer means,—the bank acceptance.

THE BANK CHECK

A check is a written order on a bank to pay a stipulated sum of money, and is drawn by one who has a deposit there. It is usually made payable to the order of a particular party and must be indorsed by that party before it can be negotiated further or cashed. A bearer check is payable to anyone who holds it. Legally, the check is an implied promise on the part of the drawer that there are sufficient funds in the bank to meet it.

The operation of bank checks is so common that no explanation need be given. They are of great utility in modern commerce, inasmuch as they effect settlements between distant points and eliminate the inconvenience attendant upon the handling of actual money in the form of bank notes and specie.

THE BANK NOTE

A second way in which a bank extends its credit is by the issuance of bank notes. Though under the Federal Reserve System, banks are discouraged to issue their own notes to circulate at par, this function has not, however, been withdrawn entirely, but has been transferred from the banks that previously issued them into the privileges exercised by the Federal Reserve Banks, which today do most of the bank note issuing. The bank, may however, upon the discount of proper security with the Federal Reserve Bank, receive the proceed in Federal Reserve notes.

THE BANK DRAFT

The bank draft is another form by means of which bank credit is extended. It is an order by one bank on another bank, the same as a bank check is an order by a commercial firm on a bank. Practically all banks keep funds on deposit with banks in other cities, especially in the large financial centers, in order that they might be able to meet the demands of their customers for a form of payment which will be accepted without question. Banks draw against these accounts by selling their drafts to their customers, charging as a consideration for the service a small sum in the form of "exchange." Bank drafts pass as practically cash everywhere in the country, and are an important means by which settlements are effected by commercial as well as financial concerns. Drafts on New York are denominated "New York exchange" and are accepted all over the country at par, owing to the fact that New York is the commercial and financial center of the country and that businessmen everywhere have dealings with New York.

THE BANK ACCEPTANCE

Among the many radical changes in the mechanism of national and international finance which the war has brought about, few, if any, have been as important as the creation of the American bank acceptance, the recognition of the trade acceptance, and the establishment of the American discount market.

In this connection, before taking up the treatise on bank acceptances, their uses and advantages, it might be of interest to briefly review the historical aspect of this new form of credit and to learn the ex-

periences gained by other nations while the use of the acceptance was in the process of evolution in this country.

HISTORICAL ASPECT OF THE BANK ACCEPTANCE

The acceptance may be said to be the simple and logical product of generations of trade and banking experience. The greatest advance in the acceptance method has been made by the leading European countries, which long ago proved to themselves that the acceptance is capable of meeting all the requirements of commerce and trade. Along these lines, therefore, have the systems of banking in Europe been worked out. The acceptance established a system under which commercial credit assumed a position of pre-eminence as a controlling attraction for liquid capital,—a position in the money market to which that form of credit was rightly entitled.

ENGLAND THE FIRST COUNTRY TO DEVELOP SOUND BANKING SYSTEM

To England, however, must fall the honor of being the first to realize the great advantages in the employment of the acceptance as the basis of its credit system, since they were the peoples to lend their credit to others through the medium of this form of paper. As a result, that country today foreshadows all the others in having developed a sound financial system on the basis of a sound credit system.

THE LONDON MERCHANT BANKERS

The merchant bankers of London were originally import merchants of exceptionally high standing, who paid for their imports by "accepting" long time drafts drawn upon themselves by shippers in foreign countries. After these drafts had been accepted by them, they were discounted with Deposit Banks or Private Bankers at rates which had a distinct relation to the standing of the acceptors. In this way, the acceptance was created.

Merchants of a moderate standing then endeavored to follow the procedure of the larger houses but were unsuccessful in the early stages, which made the financing of their importations a hardship. They either could not borrow against their own acceptances at all, or, if they could, the rates charged for interest and commission to

insure the risk were so high that the final cost of the imported wares left too small a profit to compensate them for their labor.

These merchants discovered that by borrowing the signature of one of the leading merchants, they could finance their imports more advantageously. They found that in this manner they could acquire advantages far more valuable to them than the small commission paid for the service rendered by such leading merchants. At the same time, the leading merchants realized the opportunities for profit to themselves in lending their signature by way of accepting drafts for other merchants. This encouraged them to continue the process on a larger scale. On account of the knowledge which they were able to acquire, by reason of their extended facilities and experience, on conditions of trade, as well as their knowledge of various kinds of merchandise which were to be imported and which were pledged as security, of values, seasonal demands and markets, the leading merchants were indeed qualified to grant such credits, that is, to lend their signatures for a consideration.

ACCEPTANCE BUSINESS FIRMLY ESTABLISHED

In the course of time these merchants turned more and more to the business of lending their credit in the form of acceptances, not only at home, but to foreign merchants, banks and corporations. In connection with this work and on account of their intimate knowledge of certain overseas countries, they became pioneers in extending loans abroad, and thus exerted a vast influence on the extension of English foreign trade.

FRANCE AND GERMANY

Turning now to the economic history of France and Germany, these two countries were likewise developing credit systems of their own. The foreign trade of both France and Germany increased step by step, and the ever increasing demand for acceptance credits, whereby to finance overseas trade, called for the development of the same facilities extended by the English merchant bankers for the benefit of English trade and commerce.

FIRST EFFORTS TO ESTABLISH ACCEPTANCE BUSINESS UNSUCCESSFUL

Both France and Germany had at that time, in the economic histories, been patrons of the banking system of England. However, the

time had come when an effort had to be made by both to break away from London and establish their own acceptance market for the creation and absorption of credit paper.

But their efforts in the first instance were far from successful, and the franc and mark were found to be poor competitors alongside of the English pound sterling. The reason for this was due to the fact that London was the only free gold market in the world, and it was a well known fact and a practice in national and international commerce, that a bill on London meant gold and nothing but gold, if demanded. Another reason was the superiority of the London discount market, which, guided by a far sighted discount policy on the part of the Bank of England, was always able and willing to absorb any bills offered in the market.

Of great importance to the further development of the English system of discount and rediscount, was the final recognition of this undeniable preference of the pound sterling, as a result of which a number of the most powerful continental banks established branches in London, bringing along with them large sums of money and additional facilities for the granting of sterling acceptance credits, particularly, of course, for the benefit of the customers of their home country.

THE BANK ACCEPTANCE TODAY IS USED IN MOST IMPORTANT COUNTRIES OF EUROPE

From the early periods of the development of English banking until the present day, a review of the system of credit in England shows remarkable growth. There, a broad discount market capable of absorbing all the commercial paper produced by the nation's business is at all times in existence.

The countries of France and Germany were able, in time, to establish the franc and the mark in the international commerce carried on by the merchants of their respective countries, and, while their development has not yet reached the importance of the pound sterling nor has their acceptance business reached that of England in volume, still, the benefits from the introduction and development of a system of discounts in the respective countries, have brought home to their merchants a decided advantage in the conduct of their trade.

Some of the factors that have been found particularly effective in establishing acceptance markets in foreign countries have been large exports, with which to offset imports; direct steamship connection

with all important overseas ports; the establishment of a charter market; the upbuilding of insurance companies to underwrite marine and other risks; extension of loans to foreign governments, thus encouraging and creating valuable trade relations; extended and direct means of communication with foreign governments; and lastly, the strengthening of the financial structure at home and the establishment of a stable and elastic discount market.

THE BANK ACCEPTANCE IN AMERICA

In the same manner in which both France and Germany patronized the acceptance facilities of England, so, under similar circumstances, until the establishment of the Federal Reserve System in 1914, was America one of Europe's best customers in the use of its acceptance facilities. The common practice of financing American foreign trade was upon the basis of the pound sterling, and later, occasionally through Paris and Berlin. The annual tribute paid to Europe for this service was not only an unnecessary burden, but also reflected upon the dignity of a nation of the political and economic importance of the United States of America.

CREATION OF BANK ACCEPTANCES MADE POSSIBLE BY ADOPTION OF FEDERAL RESERVE SYSTEM

In short, the introduction of the Federal Reserve Act finally gave to national banks the power to "accept." The development of the acceptance in the United States was further made possible by the fact that the war had seriously affected the ability of foreign institutions to continue their acceptance business along normal lines. America, as a result of the great war had become the world's workshop, and its export trade increased to unparalleled figures. Aside from its trade with Europe, new markets were developed throughout the world, calling for greater banking facilities.

BEGINNINGS OF THE AMERICAN BANK ACCEPTANCE

During the first year of the war, certain such drafts as were drawn upon American banks in dollars, when offered in the foreign markets, were looked upon by the foreign bankers with doubtful eyes and were not so favorably accepted from the start as were acceptances drawn in pounds sterling.

Slowly but surely, the banks and bankers all over the world began to realize that America had set its new financial machinery in motion; that a discount market was rapidly being established, and that bank bills drawn on New York could readily be discounted and at advantageous rates. As a consequence, foreign bankers began to quote closer rates for such bills, especially since, simultaneously with these offerings of American bank acceptances, a strong demand for remittances on New York and other American centers sprang up.

Previous to the introduction of the bank acceptance in the United States, the usual custom employed by merchants in this country to finance their overseas trade was by the drawing of bills on London, Paris or Berlin for the purpose of effecting a settlement of their debts, leaving the risk of exchange to themselves. The amount paid by American business establishments to foreign banks and bankers alone mounted into the millions of dollars. With the new conditions that arose, due to the circumstances resulting from the war, the acceptance came into use and was shown great favoritism by the leading banks and bankers of the country. Foreign countries also became ready buyers of American bank acceptances wherewith to create New York funds, selling such funds in turn to their customers who had debts to meet in the United States. In this way, a means was created for the ebb and flow of credit transfers between the United States and foreign countries, with the result that at present the American dollar is quoted at all the principal exchange markets of the world.

CHAPTER XVIII

Bank Acceptances

Definition of bank acceptance.—A banker's acceptance is defined by the Federal Reserve Board as "a bill of exchange of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged in the business of granting banker's acceptance credits."

Trade and bank acceptances distinguished.—The trade acceptance arises from a transaction between the buyer and the seller. The bank acceptance is the result of the granting of credit by a bank or banker. The trade acceptance is accepted by the buyer. The bank acceptance is accepted by the bank as the agent of the buyer.

Bank acceptances, how created.—In the same manner in which the individual or the firm can command credit, so is the bank capable of extending its credit to its customers, where, for a consideration, it permits its customers to use its credit, which may be either secured or unsecured, depending upon the business character and the financial responsibility of the applicant. Bank acceptances herein referred to arise out of commercial transactions.

Distinction between a bank's acceptance and a bank's note.—When a member bank of the Federal Reserve System accepts a draft or bill of exchange drawn against it, it enters into a contract substantially similar to that of the maker of a note, so that, while the form of the instrument differs, the legal effect is the same. The use of a bank's acceptance, however, differs from the use of its promissory note. When a bank accepts a draft or bill of exchange for one of its customers, it merely lends its credit responsibility to that customer in order that he may procure the funds elsewhere. The holder of a bank's acceptance has the same legal rights against the bank as the holder of its promissory note.

Credit standing of bank acceptances based upon bank's credit.—The degree to which the credit value of bankers' acceptances is meas-

ured is by the standing and credit of the accepting bank. The financial standing of banks is generally better known than that of individuals, firms, corporations or others, eliminating to a great extent the necessity and inconvenience of investigating the standing of the drawer or the indorsers. The holder of a bank acceptance knows that the accepting bank is entirely responsible. The holder knows also that if the credit of the bank is good, he need have no fear of poor security, as the bank is primarily liable.

Acceptances by member banks of the Federal Reserve System.— Under the provisions of the Federal Reserve Act, member banks are permitted to accept drafts which have not more than six months to run, exclusive of days of grace, arising out of one of the following ways:—

1. They must have originated from a transaction involving the importation or exportation of goods.
2. They must have arisen from a transaction involving the domestic shipment of goods, and must have had shipping documents attached at the time of acceptance securing or conveying title to the goods.
3. They must have been secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title to readily marketable staples.

Member banks may accept bills of the classes above designated up to fifty percentum of their capital and surplus. Where permission is obtained from the Federal Reserve Board, such member banks may accept paper of the class above mentioned up to one hundred percentum of their capital and surplus. Acceptances arising from domestic transactions may not exceed fifty percentum of the capital and surplus of the bank. The bank is prohibited also from accepting for any one person, firm, company or corporation, drafts aggregating more than ten percentum of the capital and surplus of the member bank. But, where drafts above referred to, carry with them the documents or other security, the latter limitation does not apply.

Bills drawn to furnish dollar exchange.—The fourth class of bankers' acceptances comprises bills drawn on member banks by banks and bankers in foreign countries, for the purpose of furnishing dollar ex-

change. These may be accepted by the former to an amount not in excess of fifty percentum of their capital and surplus, provided the maturity of such drafts is not more than three months, exclusive of days of grace.

Applications for privilege of accepting required to be filed with Federal Reserve Bank.—Any member bank with an unimpaired capital equaling at least twenty percentum of its paid-up capital, desiring to accept up to one hundred percentum of its paid-up and unimpaired capital stock and surplus, as above described, is required to file an application with the Federal Reserve Board, through the Federal Reserve Bank of its district. The Federal Reserve Bank then reports the financial status of the applying bank to the Board and states whether the general financial conditions in the district are such as to make the granting of the application advisable, whereupon, the application is approved or rejected. The Federal Reserve Board has also provided that any applications which are approved may be rescinded by giving ninety days' notice to the member bank.

Limitations as to amount which any one member bank may accept.—The fifty percentum limitation on drafts accepted for the purpose of furnishing dollar exchange is not to be included in the limits placed by the Act upon acceptances of a member bank of drafts and bills of exchange drawn against the shipment of goods or against warehouse receipts covering readily marketable staples.

Purchase by member bank of its own acceptances.—Member banks which purchase their own acceptances before maturity are not required to include them in the aggregate of acceptances authorized by the Federal Reserve Act. It has been necessary in the past for banks, in order that the acceptance market might be developed, to buy many of their own acceptances. While it is undesirable in the opinion of the Federal Reserve Board for a bank to buy its own acceptances, it is essential that the credit of the accepting bank be protected through such purchases where the market conditions prevent absorption. The purchase by a bank of its own acceptances is equivalent to a loan or advance to the customer for whom the acceptance is made, and the liability of the customer is subject to the limitations placed on loans. The power of a member bank to accept drafts is entirely distinct from the power to discount acceptances of others.

Eligibility of bankers' acceptances for rediscount with the Federal Reserve Banks.—The term "eligibility" applied to bank acceptances signifies what may be purchased or discounted by a Federal Reserve Bank. In order that it may be eligible, it must conform to all the requirements of the Federal Reserve Board.

Rediscount by Federal Reserve Banks of Acceptances.—Federal Reserve Banks may rediscount for any of their member banks, notes, drafts or bills of exchange, provided they have the following requisites:—

1. They must have a maturity at the time of discount or not more than ninety days, exclusive of days of grace.

2. Drafts drawn for agricultural purposes must have a maturity of not more than six months, exclusive of days of grace. Agricultural paper includes notes, drafts, bills of exchange or trade acceptances, drawn or issued for agricultural purposes, or based on the sale of live stock, and the proceeds of which have been used or may subsequently be used for agricultural purposes, including the breeding, raising, fattening, or marketing of live stock.

3. They must have arisen out of actual commercial transactions, namely, they must be instruments drawn for agricultural, industrial or commercial purposes, or the proceeds of which are to be used for such purposes.

4. They must not have been issued to carry on trading in stocks, bonds or other investment securities, except bonds and notes of the United States.

5. The aggregate of negotiable paper bearing the signature or indorsement of any one borrower, whether a person, firm, company, or corporation, rediscountable for any one member bank, must not exceed at any time ten percentum of the unimpaired capital and surplus of such bank. This restriction, however, does not apply to the discount of bills of exchange drawn in good faith against actually existing values.

General character of eligible instruments.—The Federal Reserve Board has determined that instruments themselves to be eligible for rediscount at a Federal Reserve Bank must meet the following requirements:—

1. They must be instruments, the proceeds of which have been used, or are to be used, in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production.

2. They must not have been used nor contemplated being used for permanent or fixed investments of any kind, such as lands, buildings or machinery.

3. Their proceeds must not have been used nor contemplated being used for investments of a purely speculative character.

4. They must be secured by the pledge of goods or collateral, if they are otherwise eligible.

Applications for rediscount required from member banks by Federal Reserve Bank.—Member banks are required to make application for rediscount to the Federal Reserve Bank, which will satisfy itself as to the eligibility of the instrument. Member banks must furnish with all applications for the rediscount of notes, drafts or bills of exchange, a certificate, in form prescribed by the Federal Reserve Bank, that to the best of their knowledge and belief, the instruments have not been issued for prohibitive purposes.

(For commercial banking practice under the Federal Reserve and acceptances, see Part III.)

The discount of bankers' acceptances.—By the provisions of the Federal Reserve Act, Federal Reserve Banks may discount for member banks bankers' acceptances having a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, which are indorsed by at least one member bank and which grow out of transactions involving the importation or exportation of goods, or which grow out of transactions involving the domestic shipment of goods where shipping documents are attached at the time of acceptance, or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title, covering readily marketable staples. Federal Reserve Banks may likewise acquire drafts or bills of exchange drawn on member banks by banks or bankers in foreign countries, or dependencies, or insular possessions of the United States for the purpose of furnishing dollar exchange.

Eligibility of bankers' acceptances.—In order to be eligible for rediscount, bankers' acceptances must have been drawn under a credit open for the purpose of collecting or settling accounts, resulting from transactions involving, (1) the shipment of goods between the United States and a foreign country, or between the United States and any of

its dependencies or insular possessions, or between foreign countries, or (2), the domestic shipment of goods where shipping documents are attached at the time of acceptance, or (3), they must be secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples, or (4), Federal Reserve Banks may acquire bills drawn to furnish dollar exchange which have been accepted by a member bank in accordance with the regulations relating to acceptances by member banks, and these bills must be acquired prior to the acceptance where indorsed by a member bank.

Evidence of eligibility of bankers' acceptances.—Federal Reserve Banks must be satisfied from the acceptance itself or otherwise, that it is eligible for rediscount, which evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in a form satisfactory to the Federal Reserve Bank, but no evidence is required where a bill is accepted by a national bank.

CHAPTER XIX

Procedure of Financing Imports Through Dollar Credits

Dollar Acceptances drawn on National Banks against imports are generally drawn against what is known as a Commercial Letter of Credit. A commercial credit is an undertaking on the part of the bank to loan its credit (not its funds) to a customer. The customer, who is the original recipient of this extension of the bank's credit, utilizes it by making it available in favor of the foreign shipper. He, therefore, requests the bank to notify the shipper that the latter may draw on the bank, up to a certain amount and within a certain time, provided certain specified shipping documents are attached to the draft.

For example: A and Co. of New York have bought from B and Co. in Buenos Aires, forty-eight bales of wool at thirty cents a pound, cost and freight New York; marine and war risk to be covered by A and Co. in New York, at their own expense. As this contract is subject to the opening of a ninety days' sight bank credit, A and Co. file with their New York bank the proper application for a commercial credit. (This application is to the following effect.)

APPLICATION FOR
COMMERCIAL LETTER OF CREDIT

The _____ Bank
Foreign Department
New York City _____ 19——

Gentlemen:

Please open a confirmed documentary credit by mail on Buenos Aires (name of city)

for account of Ourselves (purchaser) not to exceed the sum of about $16,000.00

in favor of B and Company, Buenos Aires (shipper) available by drafts for Full

invoice value drawn at 90 days (specify time) sight covering shipments) of 48 bales of wool at 30 cents per lb. Cost and freight, New York

to New York (destination)

against delivery of the following documents:

Invoice, Consular Invoice, Bills of Lading to the order of

The ..... Bank

Marine / War risk | insurance is to be covered by ourselves in N. Y.

Credit to be available until (shipper or purchaser) ——— (state expiration of time) 19——

SPECIAL INSTRUCTIONS: Bills of Lading Must Show Freight Prepaid

Yours truly
B and Company

The bank, having passed favorably on the application, thereupon issues its "Letter of Credit" in favor of B and Co. (Form of Letter of Credit follows.)

FORM OF LETTER OF CREDIT

LETTER OF CREDIT NO. .....

New York February 16th 1920

Messrs. B. & Company
Buenos Aires
Argentina

Gentlemen:

We hereby authorize you to value on us at ninety days' sight for account of Messrs. A. & Company, New York, for any sums not exceeding in the aggregate amount of

U. S. $16,000.
Sixteen Thousand Dollars U. S. Currency.

against shipment of eight bales of Wool at 30c per pound cost and freight New York.

Full set of bills of lading for such shipment made out to the order of the.....Bank, together with invoice and consular invoice, must accompany draft. Marine and war risk insurance are covered in New York. Bills of lading must show freight paid.

All drafts drawn against this credit to be drawn and negotiated on or after (date) and to contain the clause

"Drawn under your letter of credit No. ....."

The amount so drawn is to be endorsed on this letter of credit.

We hereby agree that such drafts as you may draw by virtue of this credit, and, in accordance with the above bills, shall be accepted on presentation and paid at maturity.

Yours respectfully,

..... Bank

A and Co., upon receiving the instrument, forward it by mail to B and Co. in Buenos Aires, or, if necessary, have its contents communicated to the beneficiaries through the bank by cable.

In order to protect the Bank, A and Co. sign an agreement as follows:

New York, ...19....

To the

..... Bank of the City of New York

Gentlemen:

Letter of Credit having been issued at (my or our) request of which a true copy is on the other side, (I or we) hereby agree to its terms, and in consideration thereof (I or we) agree with you to provide in New York, one day previous to the maturity of the bills drawn in virtue thereof, sufficient funds in cash, to meet the payment of the same with ..... per cent commission, and (I or we) undertake to insure or have insured at (my or our) expense, for your benefit, against risk of Fire, Sea and War, all property purchased or shipped pursuant to said Letter of Credit, in Companies satisfactory to you.

(I or we) agree that the title to all property which shall be purchased or shipped under the said Credit, the bills of lading thereof, the policies of insurance thereon and the whole of the proceeds thereof, shall be and remain in you until the payment of the bills referred to and of all sums that may be due or that may become due on said bills or otherwise, and until the payment of any and all other indebtedness and liability now existing or now or hereafter created or incurred by (me or us) to you on any and all other transactions now or hereafter had with you, with authority to take possession of the same and to dispose thereof at your discretion for your reimbursement as aforesaid, at public or private sale, without demand or notice, and to charge all expenses, including commission for sale and guarantee.

Should the market value of said merchandise in New York, either before or after its arrival, fall so that the net proceeds thereof (all expenses, freight, duties, etc., being deducted) would be insufficient to cover your advances thereagainst with commission and interest, (I or we) further agree to give you on demand any further security you may require, and in default thereof you shall be entitled to sell said merchandise forthwith, or to sell "to arrive," irrespective of the maturity of the acceptances under this Credit, (I or we) being held responsible to you for any deficit, which (I or we) bind and oblige (myself or ourselves) to pay you in cash on demand.

In case (I or we) should hereafter desire to have this Credit confirmed, altered or extended by cable (which will be at (my or our) expense and risk), (I or we) hereby agree to hold you harmless and free from responsibility for such confirmation, alteration or extension and from errors in cabling, whether on the part of yourselves or your Agents, here or elsewhere, or on the part of the cable companies.

This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of the firm or firms, parties to this contract or in the user of this credit, whether such change shall arise from the accession of one or more new partners, or from the death or secession of any partner or partners.

It is understood and agreed that if the documents representing the property for which the said Credit has been issued are surrendered under a trust receipt, collateral security satisfactory to the..... Bank of the City of New York, such as stocks, bonds, warehouse receipts or other security, shall be given to the.....Bank of the City of New York, to be held until the terms of the Credit have been fully satisfied and subject in every respect to the conditions of this agreement.

It is further understood and agreed in the event of any suspension, or failure, or assignment for the benefit of creditors on (my or our) part, or of the non-payment at maturity of any acceptance made by (me or us), or of the nonfulfillment of any obligation under said Credit or under any other Credit issued by the.....Bank of the City of New York on (my or our) account, or of any indebtedness or liability on (my or our) part to you, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon, at your option then or thereafter exercised, without notice, mature and become due and payable.

It is understood and agreed that you shall not be held responsible for the correctness or validity of the documents representing shipment or shipments, nor for the description, quantities, quality or value of the merchandise declared therein.

.....

.....

B and Co. in Buenos Aires, upon receiving the credit, and having ascertained that the terms of the credit agree with the terms of sale, place the shipment aboard steamer, prepaying the freight according to contract, and taking out the bill of lading in the name of the New York bank, according to the terms of the credit. B and Co. then draw up their draft for the invoice amount. (For form of a draft used for similar purpose, see Part IV.)

To this draft are attached the invoice, consular invoice and full set of bills of lading. B and Co. take these to their banker in Buenos Aires, producing at the same time the Letter of Credit of the New York bank. The Buenos Aires banker thereupon buys the draft with the documents attached, at the current rate for bank drafts at ninety days sight on New York, paying B and Co. the equivalent in Argentine currency.

B and Co. get a high price for their dollar draft, because:

1. The discount for the ninety days, which the draft has to run after it is accepted, is figured according to the New York discount market,

which on the average is likely to be considerably below that of any other money center.

2. No bill stamp is charged in New York, as is the case in London or the continent.

B and Co., the shippers, having knowledge of these advantages, are therefore able to quote to A and Co. a lower selling price for the merchandise than would have been possible had A and Co. offered a pound sterling or other credit. In other words, the American importer is enabled to derive the full benefit growing out of the use of the dollar credit.

The Buenos Aires banker in the meantime has forwarded the draft and documents to his New York correspondents, who, upon arrival, present them to the drawee bank for acceptance. The latter, upon verifying the draft and documents with the terms of the credit, "accepts" the draft by affixing its stamp and signature and returns the same to the party that presented it, retaining, however, the shipping documents. (For form of accepted banker's draft used for similar purpose, see Part IV.)

The presenting bank either holds the draft until maturity or discounts it in the open market, in accordance with the instructions of the South American banker. In the meantime, the steamer carrying the wool has arrived, and A and Co. request delivery of the shipping documents in order to enable them to make custom house entry and take possession of the goods. It will be readily understood that by giving up the shipping documents the New York bank is giving up its only collateral. The bank's interest must be protected, and the documents are therefore surrendered against cash, under rebate for the unexpired time the draft has to run, or against approved security; or, if the client is of good financial and moral standing and has the confidence of the bank, against what is called a "Trust Receipt." (See Form of "Trust Receipt," Part IV.)

According to the Trust Receipt the customer is obligated to hold the goods in trust for the bank, and, when sold, to turn the proceeds over to the bank immediately upon collection of the money, which is to be used in liquidation of the amount of the acceptance. As we have seen from the "Agreement," the money to meet the acceptance must be paid to the accepting bank at the latest one day before the maturity of the draft. By that time (after ninety days) the goods have usually been disposed of, and these acceptances are therefore essentially self-liquidating.

THE FINANCING OF IMPORTS THROUGH DOLLAR ACCEPTANCES

The dollar acceptance has established itself formally in the estimation of the American importer and exporter, and has taken a leading position

in the world's credit markets. Formerly, the American merchant was required to pay to the London banker a handsome commission for the latter's services in the financing of his foreign trade transactions. Not only was this operation costly in the respective commissions, but it also entailed a good deal of lost time on the part of the American merchant, for if he desired a sterling credit, he found it necessary to establish one in most cases through the medium of an American bank. This entailed a good deal of lost motion as well. Besides, the commission which he was required to pay for this service to compensate the American as well as the English bank on which the credit was drawn, must have been sufficient for both. In other words, the importer by availing himself of sterling credits, was required to pay two commissions. The dollar credit eliminates, for the benefit of the importer, the wastage of time and of money, for he deals with only one bank and is required to pay but one commission, and besides, the time required to consummate the financial arrangement is far less than is the case under sterling credits.

ELIMINATION OF RISK IN EXCHANGE

Under the system of foreign credits, the American importer assumes the risk at all times incident to the fluctuation of exchanges. Assume that the importer has made arrangements for the establishment of a credit available to his correspondent at a distant point, and that sometime later, the obligation becomes due and payable at the bank. Suppose the rate of exchange has in the meantime risen to a considerable figure over and above the rate prevailing at the time the credit was arranged for. The importer is therefore required to carry this risk at all times, the result of which in many cases deprives him not only of his profits but of his investment in the transaction as well. In the case of an acceptance in foreign money, the risk of exchange is an all important factor in view of the extreme fluctuations to which the exchanges are sometimes subject. In availing himself of the dollar acceptance method, the American importer knows exactly what his goods cost him and there is no ambiguity as to how much money he owes his bank at the time the acceptance falls due. He can then operate with assurances of success.

BENEFIT OF THE MONEY RATES QUOTED IN THE NEW YORK MARKET

As a result of the war and the development of the bank acceptance in this country, a discount market for this class of paper has been created with ever increasing demands for the same as an item of investment and

as an equalizer of the cash and investment positions of banks. Due to these facts, the money rates quoted in the New York market are on the average likely to be lower than those of other money centers. This also is an important factor to the importer in this country for he then may have the use of the money at an economical expense.

ADVANTAGES OF DIRECT SERVICE

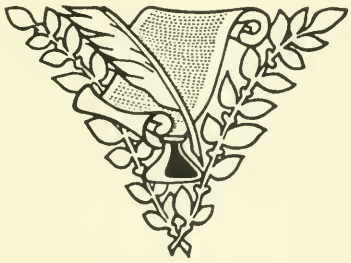
The American importer in this connection is able to spare himself from the contingencies frequently arising in connection with foreign shipments, such as short weights, losses, damages, etc.. If it should happen that they occur, they may be adjusted more properly, cheaply and effectively between the American banker and the foreign shipper or his bank, than if such adjustments had to be made via the London banker as would be necessary in using a sterling credit. At the present time this convenience is of exceptional importance to the American importer as the abnormal fluctuation in prices for all kinds of merchandise makes or unmakes a deal, according to the promptness with which the bank is able to support the transaction on behalf of the importing merchant. This is an advantage of dealing directly and in which the elimination of a second intermediary party cuts out time and trouble otherwise incurred.

ECONOMIC VALUE TO THE NATION ARISING FROM THE USE OF DOLLAR CREDITS

Quite apart from the direct economy to the individual resulting from the use of the dollar credit is the broader question of the economic value accruing to the nation as a whole through the designation of the dollar as the basis of value in our credit transactions with the rest of the world. The volume of our imports during the past decade has increased rapidly. Before 1900, the total of our imports amounted to less than one billion dollars. The volume today has risen to from three to four billion dollars. Included in the imports are products from all parts of the world shipped direct to our own shores, and while no nation enjoys higher international credit than the United States, yet it is a fact, that in order to finance the movement of our imports, we have been compelled to have recourse to indirect channels and call on foreign money centers to furnish us with the necessary credit facilities to take care of a large part of our imports. For this accommodation, the American merchant has had to pay millions of dollars annually, in interest, commissions and other charges. Today,

with the general adoption of the dollar credit and its more extended use, these charges can be saved and an economy effected to the benefit of our commerce as a whole.

At no time in the economic history of the United States has the purchasing power of the dollar in foreign markets been greater than it is today because of the varying premium which the dollar commands at present, practically throughout the world. The time is present to increase the prestige of the dollar and to standardize its use in the liquidation of our direct purchases abroad. To this end, the co-operation of the merchants of the country and of the bankers to extend the use of dollar credits is, therefore, necessary.



CHAPTER XX

Procedure of Financing Exports Through Dollar Acceptances

The procedure of financing exports through the medium of Dollar Acceptances differs somewhat from that of financing imports.

Assume that a foreign buyer has bought goods in the United States. The American exporter who has sold the goods, demands a bank credit against which he can draw when shipment has been effected. The buyer abroad accordingly arranges with his local bank for the credit, and the foreign bank, in turn, requests its New York bank correspondent to open a credit in favor of the American shipper, available by the latter's ninety days' sight drafts on the New York bank, such drafts to be accompanied by certain shipping documents which are specified.

The American shipper, after having effected shipment and secured the bill of lading and other documents required, draws his draft and presents the latter to the New York bank for acceptance, together with the required shipping papers. The New York bank "accepts" the draft, to fall due in ninety days, and returns the accepted draft to the shipper, forwarding the shipping documents by first mail to the foreign bank.

The foreign bank turns these documents over to its client, the buyer of the goods, against such security as it may see fit. Funds to meet the acceptance on the due date are guaranteed and furnished by the foreign bank to the New York bank.

In the mean time, the American shipper, who now holds a "Bank Acceptance," in payment of his shipment, either discounts that acceptance with his own bank, or sells it in the open market at what is called "the ruling rate for member bank acceptances," thus receiving his money.

The advantages of the Dollar Acceptance in this case are obvious. The foreign buyer wants ninety days' time at the lowest cost; this the American seller gives him. Knowing that he can sell the acceptance which he receives from the New York bank at the lowest possible rate, the seller adds only a small percentage to his selling price to cover this discount. The American seller is thus enabled to quote lower prices now

than at any time before the passage of the Federal Reserve Act, when he was compelled to draw on some foreign bank, which procedure compelled him to add to his price a good margin to protect himself against loss in the exchange, a higher discount, and the cost of the bill stamps.

It may be said here that the American exporter who demands a bank credit to cover his sale, is still too insistent upon receiving a "sight" credit, under which he receives "cash against documents." If we are to remove a positive restriction from our export trade, it is imperative that our exporters consent to the drawing of "long" drafts on American banks which open credits, if so requested by the foreign buyers. The latter want time in which to make a "turnover," and this can easily be granted by the American sellers at low cost and little or no risk. The excuse of some business houses that they do not care to be contingently liable as drawers of these acceptances is irrelevant, since such contingent liability is unimportant in view of the fact that the acceptors of these drafts are strong banks which have become still stronger on account of membership in the Federal Reserve System.

Not all exports are covered by "Bank Credits,"—in fact, the majority are not. Notwithstanding, Bank Acceptances have been successfully employed in the financing of our export trade, particularly exports to South and Central America, the banks paying with their credit by giving their "acceptance" instead of paying with funds when purchasing documentary drafts on those countries.

Bank Acceptances may be employed in anticipation of actual exports. For instance, a merchant has a large order for an export shipment. He may, after having made proper arrangements with his bank, draw long term drafts on the latter, and use the funds thus created for the purchase or preparation of the shipment. After the shipment has been made, the draft on the foreign purchaser or the foreign purchaser's bank, together with the relative shipping documents, may be handed in to the bank for discount or collection, the bank in turn using the proceeds of this draft in liquidation of the original acceptance.

This method has been successfully used since the outbreak of the war, and due credit should be given to the Federal Reserve Board for its intelligent and practical interpretation of the law.

DOLLAR ACCEPTANCES

a "Against domestic shipment of goods, providing shipping documents conveying or securing title are attached at the time of acceptance."

b "Secured at the time of acceptance by warehouse receipt or other such document conveying or securing title covering readily marketable staples."

In order to finance his purchases and take advantage of the cash discount, the merchant formerly went to his bank and borrowed on his own promissory note such funds as he required. The rate of interest which he had to pay varied according to the state of the money market, while the money market in turn always showed the effect of our old banking system, with its lack of rediscount facilities and its consequent tendency to sudden and abnormal fluctuations.

Today, the merchant who wants to borrow is privileged to pursue a different course. Let us take the case of a buyer who has to meet a draft for $50,000, covered by domestic shipping documents.

The buyer, having made the proper arrangements with his bank, authorizes the latter to "accept" the seller's draft for $50,000 drawn upon the bank—(*not* upon the buyer), provided the draft is accompanied by certain specified documents, such as invoices, railroad bills of lading, etc. There are instances when it is more practicable that the customer himself draw upon the bank instead of the seller. However, the other method is the more usual one. The draft is presented by the seller, accepted by the bank and returned to the seller. The documents are withheld by the bank and turned over to the customer against the familiar trust receipt.

The seller now has the "Bank Acceptance" for $50,000 which he can readily discount in the open market. Thus, actual funds are provided under competition by the banking and investing community at large.

The procedure of creating Dollar Acceptances secured by warehouse receipts or other documents covering readily marketable staples does not vary materially from that outlined above, except that the customer of the bank usually does not designate any third party to draw the draft on the bank, but draws it himself.

The advantages of these acceptances are four-fold:

FIRST: The seller receives his money promptly.

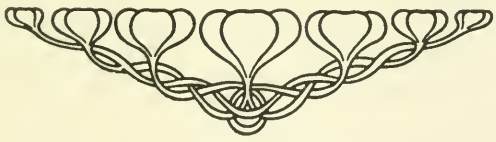
SECOND: The bank's customer has obtained his loan (or rather credit) at a lower cost than by the use of his promissory note, the rate for a three months' promissory note, all other things being equal, being higher than the discount rate for a three months' Bank Acceptance

plus acceptance commission. This difference is eloquently illustrated by the different valuation applied by European bankers to an investment of ready negotiability—as compared with one that locks up the funds of the bank.

THIRD: The bank is able to accommodate its customer more readily, since it advances only its credit, the ultimate buyer of the Acceptance advancing the actual money.

FOURTH: It has a balancing effect on the money market.

Thus, through the use of the Bank Acceptance the bank can take care of the needs of its customers without carrying their paper in its portfolio. In other words, the bank, in granting accommodations, is not dependent upon the amount of loanable funds it has available.



CHAPTER XXI

ACCEPTANCE CORPORATIONS

Their Importance to the Development of a Discount Market

What is regarded as most important to the development of an open discount market for the country is the so-called "acceptance corporation." Prior to the passage of the Federal Reserve Act, the banking institutions of this country operated under the National Bank Act or under the various State laws. These several laws imposed limitations upon the activities of State or Federal chartered banks. For example, a national bank was prohibited from having any liabilities in excess of its unimpaired capital paid in, other than to its stockholders for its capital stock, to its depositors for its deposits, or to persons who might hold its notes of issue, or drafts or bills drawn against money on deposit to the credit of the national bank or due to it. State laws imposed similar restrictions upon State institutions.

The acceptance of time drafts drawn upon banks and payable in the United States was hardly possible, and, as a result, letters of credit to finance the importation or exportation of merchandise were not issued by American banks. Foreign banking business was financed principally by the larger American banking institutions which maintained correspondents in the principal cities abroad. Through these means, banks in the United States were able to issue credits in terms of foreign currency.

Prior to the passage of the Federal Reserve Act, most of the international business and finance was carried on through London, and sterling exchange was almost the exclusive medium used by the American banker and merchant in the financing of their foreign trade.

Introduction of the American Bankers' Acceptance

The Federal Reserve Act passed in 1914, gave the power to member banks of the system to accept drafts drawn upon them up to fifty per cent. of their capital and surplus, provided they were drawn in conformity with certain specified restrictions and limitations. A few of

the larger banks throughout the country readily took advantage of this opportunity and began issuing dollar credits on account of the advantages and economies which the dollar credit offered in comparison with credits issued in foreign currencies. The importer and exporter in this country readily favored this means of financing their foreign trade through the dollar credit, as it afforded them a cheaper rate of commission, and economies in time and expense by dealing direct and only with the American bank.

In the issuance of foreign credits, a merchant was not sure of the cost of his goods until he had transacted for the purchase of enough exchange to cover the draft for each particular transaction, and furthermore was compelled to make payment at least ten days or more before maturity of the foreign draft in order to enable his bank to have funds in the hands of its foreign correspondent at the date of maturity. Another way in which he could place funds in the hands of the bank in the country where the credit was issued was by means of "cabling" the sum at his own expense, say two days or so before maturity.

By using the dollar credit, the American merchant is always assured of the prices of his goods as there is no question of fluctuating exchanges, for the merchant pays only in dollars. The dollar credit also saves the importer interest, and he pays the issuing bank the day before maturity of the draft.

During the war, on account of high interest rates in European centers, bank acceptances became more favorable and the value of dollar credits issued rapidly increased. Dealings in bank acceptances progressed to such a point that the few banks who were issuing them soon found that the demands of their customers could not be met under the restrictions imposed by the Federal Reserve Board. An amendment was, therefore, passed to the Act permitting member banks under certain conditions prescribed by the Federal Reserve Board, to accept up to one hundred per cent. of their capital and surplus instead of fifty per cent., which was the original limit. Even these increased facilities, favoring the acceptance powers of the member banks were soon found to be inadequate and the demand for American dollar credits soon exceeded the supply. The Board at Washington quickly realized that if the banks of this country were going to finance the importation and exportation of merchandise to and from the United States, some substantial enlargement of their facilities would have to be granted.

THE RISE OF ACCEPTANCE CORPORATIONS

In 1916, an amendment was passed to the Federal Reserve Act, allowing member banks to invest up to ten per cent. of their capital and surplus in corporations organized to do a foreign or international banking business, and a number of such corporations have been organized as a result of this amendment. They specialize in the issuance of dollar credits and in the acceptance of drafts drawn upon them.

The Federal Reserve Board has imposed various restrictions upon the operations of these discount corporations, which may be enumerated as follows:

1. They are not permitted to receive domestic deposits, though they may receive deposits which are incidental to the carrying out of transactions in foreign countries or dependencies of the United States.
2. Against such deposits, a reserve must be obtained, which corresponds to that required of member banks located in central reserve cities.
3. They may accept drafts and bills of exchange for all transactions permissible to member banks under provisions of the Federal Reserve Act, but are obliged to make no acceptance for account of any one drawer at any time in amounts in excess of ten per cent. of their subscribed capital and surplus, unless:
   (a) The transaction is fully secured, or,
   (b) Arises from the exportation or importation of merchandise, and
   (c) Is guaranteed by a bank or banker of undoubted solvency.
4. Whenever the aggregate of acceptances of any one corporation outstanding at any time exceeds the amount of its capital and surplus, fifty per cent. of all acceptances in excess of such amount shall be fully secured.
5. Whenever the aggregate of such acceptances exceeds twice the amount of the subscribed capital and surplus, all acceptances outstanding in excess of such amount shall be fully secured, whichever of said two requirements shall call for the smaller amount of secured acceptances.
6. The aggregate of all acceptances outstanding plus the total of all deposits held by any corporation must not exceed six times the amount of that corporation's capital and surplus, except with the approval of the Federal Reserve Board.
7. Discount corporations are required to maintain a reserve of at least fifteen per cent. in liquid assets as security for all outstanding acceptances, which reserve shall consist of cash bal-

ances with other banks, bankers' acceptances, or such securities as the Board may from time to time permit.

8. These corporations are required to make two reports annually to the Federal Reserve Board, covering such details of their operations as may be prescribed and as subject to such examinations as the Board may order.

Regarding "6" above given, the Federal Reserve Board has already in some cases given permission to acceptance corporations to create acceptances to the extent of twelve times their capital and surplus. The ratio of liabilities on account of deposits and acceptances, therefore, is twelve to one, a figure which is quite on a parity with some of the largest and strongest banks in this country. Out of an increased demand for dollar acceptances and dollar credits and out of the inability of the existing banks to supply the demand, the acceptance corporation came into being.

CREATION OF NEW ACCEPTANCE CORPORATIONS

Since the amendment to the Federal Reserve Act permitting national banks to hold stock in such corporations, a very rapid development in the formation of acceptance corporations has been the result. A number of these corporations have been organized and are to-day conducting business in the various large financial centers of the country. Their principal functions are the development and extension of foreign trade and the establishment of branches in foreign countries.

The policy of the Federal Reserve Board in this connection, has therefore been a very wise one, as it places at the disposal of the American importer and exporter, through these acceptance corporations, a means of securing dollar credits with numerous advantages which they afford over other credits controlled by other exchange markets. The acceptances of these corportions sell in the open market at varying rates of from one-sixteenth to three-sixteenths per cent. higher than the acceptance of prime member banks.

The discount corporations that have been organized and the various banks that have been instrumental in the development of the bank acceptance and dollar credits in this country have realized the necessity of creating a discount market similar to those of the European nations. Under present conditions, the ultimate market for most of the bankers' acceptances is the Federal Reserve Banks. During the

war, with the problems of Government financing on short term obligations at attractive rates, and the system of call money lending to which banks and the investing classes still adhere, there has not been afforded a maximum of assistance to the development of an open discount market. Conditions of this nature, however, cannot be expected to continue, for the time will surely come when Government obligations will be cancelled to a large degree. These will have to be filled by some other form of high grade investment—not only from the standpoint of the individual but of the business man, and particularly, the bank.

EFFECT OF CALL LOAN SYSTEM TO ACCEPTANCE GROWTH

The most serious cause retarding the development of an open discount market for the country is as heretofore mentioned the call loan system. Most of the larger banks, because of the higher yield from this class of loan, are tempted to continue to carry their reserves in this way, instead of in prime commercial paper of the class of bankers' and trade acceptances. The country banks, too, find it more profitable to transmit their funds to the larger cities to be loaned out at call money rates. Since call money rates have on the average been high, banks have clung to this form of investment.

The development of a wide discount market in bank and trade acceptances will not only supply a means of investment to the banks of the country for their resources, but will tend to put buyer and seller of funds together, because of the investment advantages, and so make demands meet supply.

No better basis for a discount market could be selected than the acceptance, representing as it does, paper of the highest class, and carrying evidence upon its face of a commercial transaction which gave it birth.

But to this plan, the coöperation of the banker, the business man, and the investor is necessary. Realizing their advantages, encouragement in the use of acceptances should always be forthcoming by the commercial and financial interests of the country.

THE NEW EDGE ACT FOR FOREIGN FINANCING

Of very great importance to the clarification and strengthening of the position of these acceptance corporations, it is hoped will be the

so-called Edge Act, passed December 24, 1919, the principles of which, together with the text of the law, are given in Part V of the present work. On the whole, it is the opinion that these acceptance corporations will grow to be among the most powerful institutions which the country has and will materially assist in strengthening our position in international as well as domestic finance and trade.

CHAPTER XXII

THE DEVELOPMENT OF AN OPEN DISCOUNT MARKET

The Importance of Acceptances and High Grade Commercial Paper to the Maintenance of a System, Which More Than Anything Else, Furnishes a Basis for Establishing the National Ideal of a Liquid Currency

The introduction of the Fereral Reserve System prepared the way for the re-introduction of the trade acceptance and for the creation of the bank acceptance in this country, and established an open discount market for high grade commercial paper.

The expression "open market" was one with which comparatively few bankers in the country were familiar at the time of the passage of the Act. They were acquainted with existing methods as previously used and were satisfied with them. They did not desire any central authority to regulate their operations, as they believed the Federal Reserve Board would do.

The Act, the passage of which was the result of a time-worn call for banking reform, had as its ultimate purpose the establishization of a sound financial credit system.

This, the Board sought to bring about through the standardization of commercial paper, according to the nature of their origin, and by the selection of the best classes of such paper, to create a continuous market for them. The purpose of the present chapter is to outline the essential features of an open discount market and the advantages of such a market to the commercial, financial and public interests of the country.

FUNCTIONS OF THE DISCOUNT MARKET

The Open Discount Market

Importance of a Discount Market to Efficient Banking System

The mobility of reserves is a necessary complement of a good banking system. The European countries have found from experience that

the efficiency of their banking systems is dependent mainly upon the maintenance of a wide and highly developed discount market. They realized still further the importance of such a discount market in that it could act as a regulator of the banks, as well as the countries' cash and investment position, and maintain a state of liquidity of their assets.

THE DISCOUNT MARKET AS A RESERVOIR OF THE COUNTRY'S FUNDS

A discount market, for the reason that it gathers together the funds of the investing classes of the country, viz., of the commercial, investing and savings' banks, private bankers, trust funds, corporation funds, funds of insurance companies, paper brokerage and discount houses, and investors of all classes, is capable of being a reservoir for the available reserves of the country. Above all, the banker and business man wants to be assured that he can get money, other things being equal, when he wants it. If he knows that there is money to be obtained with ease by utilizing his commercial paper holdings, he will be encouraged to invest his funds in standardized commercial paper.

PERFORMS FUNCTIONS OF BUYER AND SELLER

A discount market performs the functions of both buyer and seller. It brings together the party who has money and the party who seeks it, and provides a means whereby funds which are needed may be obtained, as well as gives employment to such funds. A discount market should be wide enough to afford these facilities to the buyer and seller at all times.

DISCOUNT MARKET MAKES MOBILITY POSSIBLE

We have seen also that by the introduction of the Federal Reserve System, the reserves of the country were made capable of transfer from one part to another according to the needs of the localities. Suppose one Federal Reserve Bank finds itself in need of money at short notice. It would then discount the commercial paper held by it of another Federal Reserve bank, taking the proceeds by transfer, thus causing a flow of money from a place where it is abundant to a place where it is needed. The same is true as between bank and Fed-

eral Reserve bank, the latter rediscounting the commercial paper holdings of the former.

EQUALIZING INTEREST AND DISCOUNT RATES WITHIN THE COUNTRY

By the simple process of discounting as above described, supposing one locality should have a surplus of funds. In that event, money there would invariably loan out at a low rate. On the other hand, let us take a district where the demand for money exceeds the supply. Interest rates there would necessarily be higher. The total money supply would always tend towards maintaining equilibrium, that is, the greater supply of money would flow towards the lesser supply of money, and thus rates of interest in these two districts under consideration would thereby be equalized. This is accomplished by the discounting of bills, acceptances and other commercial paper, either between member banks and the Federal Reserve Bank or between the Federal Reserve banks themselves. Undoubtedly, it cannot be assumed that at all times it is possible to maintain a market equalized in every respect, but the variance in the rates between two markets can be kept so close to one another that its difference will not be felt so very much.

THE DISCOUNT MARKET AS AN EQUALIZER OF DISCOUNT RATES BETWEEN THE UNITED STATES AND FOREIGN COUNTRIES

A discount market operates as an equalizer of discount rates between the United States and foreign countries in the same manner as it acts as an equalizer of rates between different sections of this country. In the London discount market, because of the facilities provided and the opportunities afforded foreign banks for the investment of their resources, they have collected there in large numbers and have brought with them considerable funds which are loaned out in commercial paper transactions and so support the discount market. It is believed by bankers, economists and authorities on banking and finance that the result in the United States would be similar, and that the use of acceptances would more than anything else contribute to the development of a broad discount market.

Interest rates in two countries are seldom the same at any one time, and bankers and investors seek employment for their funds according to the higher rate of interest which is afforded in the relative markets.

The existence of a broad discount market in the United States would encourage foreign banks and investors to purchase our bills and acceptances as an investment when rates are higher in this country than abroad. This would tend to move our interest rates in sympathy with the level of interest rates in foreign countries. Should the rates decline in this country, the banks and investors here would enter foreign markets for the purchase of their bills, and foreign banks and investors would also reduce their holdings of American bills, because of the lower rates of interest. A movement would thus set in to equalize rates and keep them as nearly on a par with each other as is possible.

THE DISCOUNT MARKET AS A STABILIZER OF INTEREST RATE LEVELS WITHIN THE COUNTRY

It is a proven fact that interest rates in the United States fluctuate on a much wider scale than in European countries. Interest rates in Europe in normal times are much more steadier than in the United States, moving, except in rare cases, by only one-sixteenth of one per cent., and on the whole within narrower limits. In the United States, however, rates fluctuate from one-fourth of one per cent. to one per cent. at each instance.

A broad discount market would connect the money centers and the credit centers of abroad with this country, and by the movement of money from one center to the other, according to the movement of rates, it would tend to lessen fluctuation and would eliminate erratic movements of interest and exchange rates which are always the feature of isolated markets.

THE DISCOUNT MARKET AS A STABILIZER OF GOLD MOVEMENTS BETWEEN COUNTRIES

Gold movements between this country and other foreign countries have always been a factor of considerable importance to the American merchant, for the transfer of gold has greatly influenced the rates of exchange on foreign points.

The effect of exchange rates between two countries, the currency of one of which is of lesser value when measured in the terms of the currency of the other, is to cause banks to increase their holdings of the bills of the country the rates of which are lower. As an illustration, upon the decline in value of the dollar, foreign banks would increase their holdings of American bills on account of the cheap dollar exchange rate, while American banks would sell their holdings of foreign bills on account of the high exchange rates on foreign countries. This would tend to ward off gold movements for a time.

The leading banks of Europe have followed this process of accumulating a line of foreign bills at low rates and disposing of them when conditions are reversed. It has been carried on successfully with advantageous profits accruing to the foreign banks. Not many banks engage in the business of exporting or importing gold, this being confined principally to a small number of private banks or firms doing a banking business. The exportation or importation of gold is carried on by these banks for the purpose of yielding a profit, however small. A discount market would tend to eliminate these wasteful and temporary shifts of gold, unnecessary in the majority of cases, as settlement by commercial paper would be more resorted to.

WHAT IS NECESSARY TO THE MAINTENANCE OF A DISCOUNT MARKET

Before the passage of the Federal Reserve Act, there was no such thing that we could very well call a discount market existing in this country. The European countries which had developed extensive and effective banking systems of the highest order, all possessed wide markets affording facilities for the discount of credit instrument. It was observed by these European countries that a standardized instrument of credit would be necessary, and it is for this reason that there was developed a so-called two name and three name paper as the best and safest way in which credit might be extended and circulated.

The Federal Reserve Board realized the handicap of unstandardized paper to the creation of a discount market, and readily chose the acceptance as a high form of credit instrument upon which the existence of such market could be based; and by making a distinction as to trade and bank acceptances with their attendant advantages, has substantially eliminated to a large degree the responsibilities and dangers

involved in the open book account method and that of written instrument of various sorts as evidences of debt.

A prime banker's acceptance is a credit instrument of the highest sort and is preferred by the Reserve banks for purchase and investment. A large amount of their reserves is invested in this class of paper.

A trade acceptance, moreover, arising out of transactions involving the sale of goods, is from its very nature a more certain form of credit than a mere promissory note or a draft, which may have been drawn for a number of purposes. The Reserve banks have given their full support to the acceptance, knowing well from experience both in this country and abroad, that this method of transacting and financing business is by far superior to the open account method or to single name paper dealings. It is due to these two instruments of credit, the trade acceptance and the bank acceptance, that the foreign discount markets depend, and it is upon these two instruments of credit that the American discount market will eventually be supported.

ESSENTIAL FEATURES OF A BROAD DISCOUNT MARKET

The factors necessary to the maintenance of a broad discount market may be analyzed as follows:

1. Those creating the acceptances, or the accepting banks in the case of bankers acceptances, and the seller and buyer of goods in the case of trade acceptances.

2. Those purchasing and selling acceptances, generally the banks.

3. The central bank of rediscount; in the United States, the Federal Reserve banks; in England, the Bank of England; in France, the Bank of France, etc.

4. Discount corporations, brokers and others of a similar nature, which though considered as middlemen, are highly essential to the maintenance of a broad discount market.

In England, where the acceptance is most highly developed, the discount market acts according to supply and demand. Should the supply of bills thrown out in the market be greater than the demand for the same by the investing classes, the tendency would be to increase the rate of discount, thus putting an automatic stop to the use of acceptances and commercial paper, and thereby checking credit over-extension.

The liabilities arising on account of acceptances by the accepting banks abroad average generally from fifty to seventy-five per cent. of their capital and surplus. The acceptance banks, though not extending money but their credit, are limited in their operations.

In this country, it is believed that with the development of the acceptance, the bankers here will be enabled to operate in the same manner as the accepting banks of Europe. The liability that an accepting bank assumes is very much the same as that arising out of a "deposit," and though banks do not, by accepting, obligate themselves to give a present right to demand money, still the acceptance implies a future payment, and it is well to consider to what extent the banks could use or extend their credit if they should operate as extensively as the acceptance houses and banks abroad. To this may be said that so long as the proportion of a bank's capital and surplus to its total liabilities is of a fair ratio, it could safely pledge its credit to advantage. But the requirements of its customers for that form of accommodation must also be considered, and thirdly, the credit standing of the bank, and lastly, the attitude of the market for acceptances at the time.

The second class having a direct bearing on the discount market are the banks and other purchasers and sellers of acceptances, which constitute the active discount market. It is by the sale and purchase of drafts that the discount market is really maintained, and this is in accordance with the individual cash and investment position of the banks and investing classes. For this reason a discount market should afford wide facilities for acquiring ready cash in exchange for paper in the form of investments and vice versa.

Banks would do well in purchasing acceptances to spread their maturities so that they could continually have such acceptances maturing in quantity, thus affording both a cash and an investment advantage. In order that a properly balanced and liquid condition of its assets may be maintained, a bank must have on hand at all times a certain amount of cash. This includes the legal reserve such bank carries with the Federal Reserve Bank and its cash in vault, which constitute the bank's primary reserve.

ACCEPTANCES AS A SECONDARY RESERVE

In addition to its cash, a bank's resources should be in the form of some liquid readily saleable investments as a secondary reserve, and

it is here that the acceptance can best play its part. Of course, the position of a bank as regards its holdings of acceptances depends upon the nature of its business. Some institutions are engaged more along specific lines, as distinguished from general commercial banking, for instance, making loans on mortgages of real estate, carrying investments in the form of public credit, in which may be included government and municipal bonds, and investing in building securities. But as a ready means of obtaining cash, next to its actual available means in the form of its legal reserves and cash in vault, the acceptance, being self liquidating at short intervals, and of high credit standing, is undoubtedly the best form of secondary reserve investment. Investments in acceptances and similar high grade commercial paper are advisable in the case of banks having large volumes of deposit liabilities and where a condition of uncertainty of drawings on the part of their depositors exists.

The acceptance may properly be considered as the next best reserve to actual cash, superseding the banks' investments in loans and discounts, and further down the line, in point of liquidity, in securities, and finally in fixed investments in buildings, etc.

The advantages of the bank acceptance as a form of liquid security have been recognized by a large number of States, which have passed laws permitting savings banks organized under their laws to invest in such bankers' acceptances. The fact that these savings institutions are investors has created a continuous demand for such paper, thereby furthering the growth of the acceptance. The acceptance as a form of investment for savings banks is most advantageous, in that stocks or bonds in either railroads, industrial, mercantile or commercial enterprises, do not always maintain their book prices. Savings banks are therefore compelled to dispose of their holdings with great losses. A proportion of their resources invested in acceptances will enable them to meet initial runs with confidence and ease, and with no fear of depreciation in value.

The third component of the discount market is the central rediscounting bank, which in this country is the Federal Reserve Bank. It cannot be expected nor assumed that a discount market would always produce an equal number of buyers and sellers. In cases where the situation becomes one that is not equalized by purchases between banks, the central rediscounting bank should operate as the stabilizer by the purchase or sale of sufficient quantities of paper to keep con-

ditions normal. Frequently, the sales on the part of banks and dealers in acceptances more than exceed the purchases, and at such times the Federal Reserve Bank should purchase under such regulations as it deems wise, either direct in the open market, or from member banks a certain amount of bills, and vice versa.

The fourth factor in the maintenance of a discount market is the discount corporation and broker. These are middlemen. They act on behalf of the buyer and the seller at one time. The broker and discount corporation are always in touch with the market and know at all times the requirements of one bank as well as the objects of another to either buy or sell.

The brokers not only operate as middlemen but at times they also purchase for their own account large quantities of commercial acceptances, which they let out at intervals to the investing classes, banks, and others, thus constituting a floating supply without which a free open market would be impossible. On the whole, the broker and the discount corporation give to the discount market its effectiveness and importance, and may be considered as the white corpuscles of the acceptance market.

THE AMERICAN DISCOUNT MARKET AND ITS DEVELOPMENT

The acceptance business in the United States had its actual beginning shortly after the outbreak of the European War. Owing to changed conditions which the great war brought with it, a few large banks in this country immediately took advantage of existing opportunities and began issuing dollar letters of credit payable in the United States. However, no market for acceptances existed at that time, which greatly hindered the development of an American acceptance market. The very companies which issued dollar letters of credit had to purchase them themselves at the start, but gradually, with a knowledge of their advantages, other banks took a hand in this bidding and purchasing, which action on their part resulted in lower discount rates. Increasing bids tended to lower still further such rates until the ruling level was from three to three and one-half per cent. Later bankers and brokers began to take a more active part in their purchase, freely bidding for the acceptance, and it was then that a discount market had arisen. When the market indicated that it could absorb

more of these acceptances, discount rates fell still further, as low as two per cent. It was then that the acceptance had the push of the business and banking element of the country, as well as the support of the associations in every circle of trade, industry and occupation throughout the United States. Banks and business men, thereafter, began to take up this new method of financing. With the great favor shown to this class of paper by the leading bankers and business interests of the country, the Federal Reserve Board finally put its stamp of fitness on their use, thereby firmly establishing the American Discount Market.

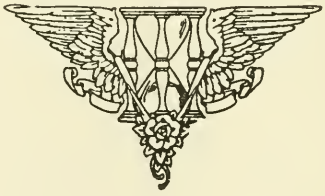
THE DISCOUNT MARKET AS IT EXISTS TO-DAY

Though still in its infancy, but making great progress, the acceptance has yet to overcome great difficulties. An important factor to be considered restricting its use is found in legislative restrictions which retard many of our banks from fully utilizing their acceptance powers. The very nature of the acceptance, that it must not be used to finance permanent investments not pure speculations, nor for the purpose of furnishing working capital, or so-called accommodations, enables a proper distribution of credit risks. By all means, the acceptance should be restricted from being used for speculative enterprises.

It is the unfamiliarity of the majority of banks, particularly the small ones scattered throughout the country, with the trade and bank acceptance and their practical usefulness, that is the real cause retarding their development. American methods of doing business under the open account and single name paper method, stand ten to one against the acceptance to-day, and must be overcome before the latter may be firmly established in this country. For this reason, it is necessary that acceptances, when used, should be used for the specific purposes out of which they are created, that is, in liquidation of current and existing transactions only.

Moreover, during the war, the development and use of the acceptance was confronted with great difficulties, arising out of governmental finance. Even to-day, the trade and bank acceptance is governed by the prices and interest yields of governmental securities. Whether they be in the form of liberty bonds or in treasury certificates, the government securities yield a standard of interest below which acceptances cannot go far without becoming unattractive for

investing banks. It is hoped that in the near future, when the government regains its credit standing which it enjoyed before the war, and, when the value of government securities will undoubtedly be enhanced, the acceptance will be looked to more and more by all investing classes as ideal for the employment of funds.



CHAPTER XXIII

Acceptances as Investments

Acceptance a new form of short term investment.—Heretofore we have confined our expressions on the trade and bank acceptance in connection with their usefulness, importance and application to commercial banking, but we have not touched upon the acceptance as a means of investment. With the development of the acceptance method in the United States and with the rapid development of the Federal Reserve System, there has been made available to the investors of this country a new form of short term investment.

Used extensively in Europe.—The acceptance is not a new instrument of credit, having been in use in the leading European nations for a great number of years. So extensive is their use in those countries that they circulate there as freely as do checks in the United States, and are used in the majority of commercial transactions, requiring credit. However well developed a system of banking based upon the acceptance, these European nations have built up, this class of commercial paper is, however, a comparatively new development in the United States. Prior to the passage of the Federal Reserve Act, banks in this country were not allowed to accept drafts drawn on them and payable at some future date. This was due mainly to the lack of knowledge of the acceptance and its advantages both as an investment and as an instrument of credit.

Importance of the Federal Reserve Act to acceptances.—The provisions and amendments of the Federal Reserve Act are of such importance to the development of commercial banking and acceptances that it is thought best to outline such as are of direct application to the acceptance market. In this country, recognition of acceptances as a sound and highly desirable investment is rapidly following the broadening field of their commercial utility.

Privileges afforded banks as to accepting and investing.—Under the Federal Reserve Act, banks are given the privilege of accepting up

to fifty per cent. of their capital and surplus, and in special cases, where applications are approved by the Board, such banks may receive the right to accept up to one hundred per cent. of their capital and surplus. The Federal Reserve System includes all national banks, many State banks, and trust companies, having acceptance proviliges, both as to acceptances and as to purchases. The present day procedure involved in investing in acceptances outside of direct dealing between buyer and seller is along the following lines:

The work of the commercial paper brokers.—Above all, it is necessary that intermediaries be established which should bring buyer and seller of commercial paper together. Thus, out of necessity, there have arisen numerous commercial paper brokers and dealers who are in close touch with commercial firms having paper to offer on the market. They are always in touch with banks and financial establishments throughout the country having money to invest. The commercial paper broker or dealer will, therefore, take acceptances from off the hands of the holders and dispose and distribute them according to the needs of the investors. These investors may be either National banks or State banks, trust companies, discount corporations, private investors, corporations, firms, and even in some States, savings banks and trust estates.

Other methods of dealing in commercial paper.—Though the commercial paper broker is considered of great importance in the proper distribution of acceptances, where his services in bringing buyer and seller together help supply to meet demand, this is not the only way in which commercial paper dealings are carried on. Banks sometimes deal directly with other banks, and sometimes deal with firms having commercial paper, direct, without the intermediaries. However, the commercial paper broker, because he is familiar with market provisions of commercial paper and knows the sources of demand most favorable to the seller as well as to the buyer, should be utilized wherever and whenever possible.

Acceptance a favorable item of investment.—The acceptance is fast becoming a favorable item of investment with the banks and investing classes. Not only is there an advantage to the banks and general financial establishments in investments in acceptances, but also to the individual, firm and to the corporation which have at various times during

the course of their business operations surplus funds which could be used for investments.

Example of use.—As an illustration, assume that a corporation has declared a dividend on its capital stock to be payable two months hence. Let us further assume that it desires to meet this future contingency and that it has ample funds on hand for the purpose. In order to avoid unprofitableness in allowing such funds to remain on deposit till it is necessary that they be disbursed, an investment in high grade bank acceptances having a maturity approximating the due date of the dividends, would give to the corporation a means of employing its funds until required. The case of the business establishment or individual is much the same, they being enabled also to loan out their surplus funds and to purchase prime commercial paper of the "acceptance" class, at better yields than otherwise for short term investments.

Discount corporations.—Coincident with the development of the Federal Reserve System permitting member banks to accept up to a certain percentage of their capital and surplus, there has also been developed in this country, as a result of the demands upon the business and financial world, a number of so-called discount corporations, which make a specialty of "accepting" paper and which are regulated in their operations in much the same way as are member banks. These acceptances arising out of commercial transactions are very high-class investments for member banks, individuals and, in fact, are sought by the Federal Reserve Banks throughout the country, as investments.

The Federal Reserve Banks and their investments in acceptances.—The growth of the investment business in acceptances by the Federal Reserve Banks has risen to many hundreds of millions of dollars during the past year, which bears evidence to the fact that they are a very desirable method of employing surplus funds.

Again, the rates established for the discount of bankers' acceptances, generally lower than those of call loans, still bear with them a greater advantage in the better security offered and the better means of liquidity, which should make them far more preferable as investments.

Other factors in the acceptance investment business.—The progress in the development of the acceptance business as an item of investment has brought into existence numerous commercial paper dealers

and brokers, who make a specialty of dealing in bank and trade acceptances. These dealers, many of whom are private bankers and well known stockbrokers, generally issue periodical bulletins called "acceptance offerings." The houses having commercial paper to offer naturally acquire them through purchase from commercial firms and general holders of bank and trade acceptances. An investor, firm, corporation, or bank, having surplus funds, chooses from the offering list the same as from a list of bonds and other securities, and selects according to the faith based upon the acceptors of the draft.

THE ACCEPTANCE AS AN INVESTMENT ANALYZED

Availibility of trade and bank acceptances.—Trade acceptances and bank acceptances at the present time are available for investment purposes in nearly any amount and for any desired maturity. Of the two, bankers' acceptances are the usual form available for investment. The bank acceptances comprise two classes, eligible and ineligible. Both forms of bankers' acceptances are dependent upon the rating and credit standing of the accepting banking institution, which places the bills accepted among the highest grade of securities. The chief responsibility rests with the accepting banks, which because of their greater credit ability and more conservative operation, obviates the necessity for close scrutiny of the drawer of the bill or its indorsers.

THE ACCEPTANCE AS AN EQUALIZER OF THE BANK'S CASH AND INVESTMENT POSITION

Liquidity of investments.—As a secondary reserve for banks, there is no other investment so liquid as the acceptance. Such a bill is a short term investment offering assurance of payment at maturity.

The open market feature of such an acceptance and the purchasing power of the Federal Reserve Banks contribute to the position of the acceptance as a premiere investment for banks wishing to establish a secondary reserve.

As a liquid investment, the acceptance is the highest form of commercial paper. Banking experience for many years has demonstrated that purely commercial loans are the safest of all temporary investments.

Acceptances as Short Time Investments

The acceptance to-day is available in almost any amount and for almost any maturity. The various banks and discount corporations making a specialty of acceptances have at all times a large supply of this class of commercial paper available for investment purposes.

One great advantage in the acceptance as an investment lies in the fact that its security is of a very high character and it is self-liquidating. As a short term investment, it is much more desirable and convenient than other means of investments. The Federal Reserve Banks employ a considerable amount of their funds in investments in acceptances, and distribute them so that their maturities are continuous. At the present time more favorable legislation is being adopted in many States of the Union favoring the acceptance as a means of investment for savings banks and trust companies. Moreover, a large number of corporations and business houses throughout the country, particularly those which favor the acceptance method, purchase quantities of this class of commercial paper according to their surplus funds.

Trade Acceptances

The second class of acceptances, namely trade acceptances, are largely bought by Federal Reserve Banks and are dealt in extensively by the banks and discount houses of the country.

The same discussions heretofore stated in connection with bank acceptances would apply equally to trade acceptances. They, too, will undoubtedly prove to be a desirable form of investment, their qualities as standardized commercial paper of a high class being generally recognized by the banks and investing houses.

CHAPTER XXIV

CONCLUSION

The Need for Wholehearted Co-operation

In the course of the development of the acceptance in this country, as in the development of other worthy purposes, difficult tasks invariably arise, not because of the question of merits involved, but for the reason that a complete understanding of the method to be introduced and extended, is lacking. The acceptance idea, coming from a national demand which arose from war conditions, for the establishization ot a sounder credit system, has today the approval of the leading commercial, financial, and governmental bodies.

It is pleasing also to find that on the whole only a comparatively slight opposition has been encountered in the development of the trade acceptance method.

TIME REQUIRED

Different minds develop different points of view. The acceptance method, where it is desired to be introduced, must clearly have its advantages shown and its merits made to be appreciated. The progress of the acceptance has been very rapid. From almost zero at the start, the acceptance today has risen to more than national prominence and importance.

However, it is not in the least strange that the entire business of the country has not yet adopted the trade acceptance method. Experience has shown, as well as the economic histories of nations, that radical changes in the business methods of a country, even though of the very best, come slowly and require serious and continued effort.

THE BANKER REVIEWED

The banker has all to gain and nothing to lose by the trade acceptance method. The acceptance has proved itself to be the best commercial paper in the field. It is the safest of all other forms of commercial paper. It may be utilized for the investment of idle funds. It is in itself an ideal

liquid asset. It creates a keener sense of business obligation, a prompter payment of debts, better business in general, and as a consequence, better banking conditions.

THE SELLER

To the seller of merchandise, we would say that the trade acceptance is yet the best plan of assistance that has ever been devised for him and a protector of his interests to the fullest extent. It carries with it a definite promise to pay, an acknowledgment of the correctness of deliveries and of the obligation itself, a shorter term of credit, liquidity of assets, better facilities for collection, closer touch with the buyer and the seller's bank, and practical relief from expenses and burdensome practices which have grown up under the open account method.

THE BUYER

For the buyer, the trade acceptance is of a particular and distinct benefit. It puts him in the classification of a preferred customer, one who serves notice on the business world of his disposition and ability to meet his obligations promptly at maturity. It gives to him greater independence of action, provides an effective check against over-buying and over-borrowing, eliminates the evils of laxity in credit extension, in speculation, and tends to establish his standing with the banks and the business community. The buyer should not be fearful of any inroads upon his privileges. The trade acceptance does not take away from him his cash discount nor his privilege to use single name paper, for they both operate smoothly and without conflict in the same field.

BUSINESS MEN MUST CO-OPERATE

There are still today great numbers of American businessmen who are uninformed concerning the details of the trade acceptance method, and therefore, unconvinced as to its merit. Some at least have given the acceptance a so-called introduction. In the majority of cases where this was done, the acceptance has come to stay. Nevertheless, others of an ultra-conservative type, while conceding its merit, are not disposed to disturb existing business conditions, which in the past have proven themselves satisfactory for their purpose. There is still another class of American businessmen, whose attitude may be described as unduly cautious. They

want all others to settle down in the use of acceptances before they themselves will adopt the plan.

THE GOVERNMENT

Nevertheless, the prospect is altogether encouraging, for in nearly every line of business is the acceptance used today. The Government has rendered the greatest assistance, through the mechanism of the Federal Reserve System, to the progress of the acceptance method. This alone has influenced many to adopt the plan. Through the establishment of wider banking facilities, the Government has given every advantage to the standardization of commercial paper and has thereby rendered an invaluable service and aid to the country.

THE BANKER

But other sources which are fully capable of rendering an equally valuable assistance to American business have been the banks, and here the question has been, "What are they doing?" Evidently, the only possible answer for this question is that if they possess sufficient business intelligence to be able to appreciate the merit of a superior article when it is presented to them for sale or discount, or of the general adoption of sounder credit methods, they, too, must have a greater interest in the plan. They must be progressive, alert to encourage every movement tending to bring about the soundest and most scientific credit system. If the banker has been accused of retarding the development of the acceptance, this situation, however, is fast becoming remedied and a greater interest is being shown daily by increasing numbers of banks throughout the country for more information on the acceptance and its principles. Even those banks which have displayed an unfavorable attitude in the past towards the acceptance method are today fast coming to realize its practical utility. Already, there has been established the basis for an American open discount market and the users of the acceptance are becoming more numerous every day. With the proper publicity to this better form of credit, by the banker, his help and co-operation towards extending its use, with the encouragement which he is able to give the business community, the progress of the acceptance will be most rapid indeed.

PART III

COMMERCIAL BANKING PRACTICE AND ACCEPTANCES UNDER THE FEDERAL RESERVE SYSTEM

Giving the Rulings, Regulations, Opinions of Counsel, General Statutory Provisions, and Amendments to 1920, in Connection with Commercial Banking Practice Under the Federal Reserve System; an Authoritative and Standard Reference Work Covering the Entire Field Relating to Acceptances in Commercial Banking Practice Under the Federal Reserve Act and Amendments Thereto.

COMMERCIAL BANKING AND CREDITS

BANK AND TRADE ACCEPTANCES

PART III

COMMERCIAL BANKING AND CREDITS

ACCEPTANCES

General Introduction

Commerce and finance owe much to the acceptance, used by other commercial and financial centres for hundreds of years with success, but only recently permitted by our banking laws.

Acceptances are daily proving more and more of advantage, alike to the banker, the domestic merchant, the manufacturer, the importer, the exporter and the investor. It has served to remove obstacles that stood in the way of a free cultivation of foreign markets, and in this connection it must be realized that a broad discount market is essential if we are successfully to compete for a share of the world's business.

Under the authority granted by the Federal Reserve Act to the Federal Reserve Board, there has been made provision for the development of a broad discount market. Briefly, acceptances under the Federal Reserve Act and in commercial banking practice may be summarized as follows:

Any national bank may have oustanding acceptances aggregating fifty per cent. of its capital and surplus. By applying to the Federal Reserve Board a bank may receive permission to have outstanding acceptances up to one hundred per cent. of its capital and surplus, but in no event may acceptances in domestic transactions exceed fifty per cent. of the capital and surplus of the bank. No acceptance may have a maturity later than six months after the date of acceptance. The amount any member bank may accept for any one person, firm, or corporation must not exceed ten per cent. of the bank's capital and surplus, but such limitation does not apply, how-

ever, where the bank is secured by some actual security growing out of the same transaction as the acceptance; the security must remain with the bank all the time the acceptance is outstanding.

With the authority of the Federal Reserve Board, a member bank may also accept up to fifty per cent. of its capital and surplus, drafts drawn upon it for the purpose of furnishing dollar exchange. When accepted for this purpose, drafts must mature within three months.

Several States of the Union have already enacted legislation permitting the banks operating under their laws to make acceptances. Further than this, it has been made legal for savings banks and estate funds to invest in acceptances. The amount and restrictions, however, vary with the different States.

The four classes of bills which national banks may accept are:

1. Those arising out of a transaction involving the importation or exportation of goods;
2. Those arising out of a transaction involving the domestic shipment of goods;
3. Those which are secured by readily marketable goods in storage.
4. Those drawn for the purpose of furnishing dollar exchange.

ACCEPTANCES ARISING OUT OF A TRANSACTION INVOLVING THE IMPORTATION OR EXPORTATION OF GOODS

Example of an importation acceptance; Procedure;—Let us assume that an importer is desirous of purchasing a quantity of manila hemp. He advises his bank regarding the particulars of the transaction, and his credit standing being satisfactory, his bank issues at his request a so-called commercial credit. By means of this credit, the Philippine exporter is authorized to draw on the bank up to a stipulated amount, which would be for the value of the hemp purchased by the importer. Furthermore, such provisions which require that drafts be drawn and negotiated on or before a certain date, and giving the usance, that is, that the drafts must mature thirty, sixty or ninety days, or whatever the period may be after sight, are included in the commercial credit. Besides stipulations as to the documents and certificates of insurance, bills of lading, etc., to the effect that they must be attached to the drafts, also appear in the commercial credit.

There are two means through which such credit may be availed of

by the exporter abroad; first, the mere mailing of the credit to the importer, and secondly, the cabling of the information through a bank located in the vicinity of the exporter.

Upon receipt of this advice, the exporter prepares his shipment, and when so shipped, that is, boarded upon the steamer, he is in possession of the ocean bill of lading and other necessary documents, and is then enabled to draw a draft on the bank in this country issuing the credit for the value of the hemp.

Let us further assume that the draft has a maturity of ninety days, and all documents required by the commercial credit in question are attached to such draft. He then takes the draft to his local bank, which purchases the draft at the current rate of exchange for ninety days' sight dollar bills.

In the above case, the shipping and other documents are all made out or endorsed so as to give the bank purchasing the draft title to the goods. The local bank in Manila forwards the draft and documents to its agency or correspondent in this country. The draft is then presented by the correspondent of the Philippine bank to the bank in this country issuing the credit, and if, after an examination of the draft and documents attached, everything is found to be in order, the bank accepts the draft, returning it to the party presenting it, who, in this case, is the correspondent of the Philippine bank. The accepting bank likewise retains all other documents necessary to be surrendered to the importer. The importer, upon giving the accepting bank a trust receipt in exchange for the documents, is then enabled to get his manila hemp. The importer thus has ninety days in which to secure the manila hemp, and dispose of it or manufacture and sell it before he is required to place his bank in funds to meet the maturing draft. The representative of the Philippine bank sells the acceptance in the open market at the prevailing rate for ninety day bills.

For making this transaction possible, the importer's bank charges him a small commission for accepting the draft. Only credits issued by the well-known banks, of course, will be acceptable to the exporter as he requires a bill which will command the best rate. This acceptance business is therefore usually handled by banks in the larger centers. The lesser known institution usually has credits required by its importers issued by one of its larger correspondents, under the guaranty of the smaller bank.

Example of an Exportation Acceptance; Procedure;—An exporter in this country, let us assume, has been asked to ship a quantity of machinery to a firm in Great Britain. The exporter is not willing to ship the machinery on condition that he draw a draft direct on his customer, nor is he willing to sell such customer on open account.

In such case, a banker's acceptance credit may be availed of. The foreign importer goes to his bank in Great Britain and has a credit arranged with its correspondent in this country to cover the value of the machinery. The British bank, let us assume, considers the credit of the importer as favorable and accordingly requests its correspondent in this country to issue the credit. The British bank, moreover, guarantees that the bank issuing the credit in this country will be placed in funds before such drafts as may be drawn upon it under the credit issued, mature. The exporter is then advised by the bank in the United States that, as requested by the purchaser, it will accept his drafts drawn upon it up to a certain amount, when the drafts are accompanied by documents as specified in the letter of credit.

The procedure in documents in an exportation acceptance is, on the whole, similar to that involved in importations, and the documents must, of course, represent the machinery which has been shipped.

As soon as the exporter secures his necessary shipping and other documents, he draws a draft on the bank here issuing the credit, having a maturity in accordance with its terms, for the value of the machinery. The exporter then presents the draft and documents to the bank issuing the credit, and everything being found in order, the bank accepts the draft and returns it to the exporter, who sells it in the market and thus receives payment for his machinery. Such documents are then forwarded to the British bank, to be released by it to the purchaser, either upon trust receipt or otherwise. The British bank, through remittances, or by charge against its balance in this country, places its correspondent in funds to meet the draft at maturity.

ACCEPTANCES ARISING OUT OF TRANSACTIONS INVOLVING THE DOMESTIC SHIPMENT OF GOODS

Procedure in the case of domestic transactions is very much similar to those involving the exportation or importation of goods.

As an example, let us take the case of a manufacturer who desires

to finance his purchases of raw material by means of bankers' acceptances. He accordingly requests his bank to issue a credit in favor of the sellers of the goods. Such credit is for a stipulated amount not exceeding to any large extent the value of the goods. Such drafts drawn to finance purchases of raw materials usually have a usance which give the purchaser time to manufacture this raw material and sell the manufactured product. They are usually drawn for a period of ninety days, as bills with a longer maturity may be said not to have a ready market. The seller will then ship his goods and draw a draft for their value on the bank issuing the credit. The draft, together with shipping documents, is then forwarded to the bank, and, as in the case of exports and imports, such documents must be so issued or indorsed as to give the bank title to the goods. The bank accepts the draft and returns it to the shipper, who disposes of it at the prevailing discount rate. The documents are turned over to the manufacturer, probably under a trust receipt, and he is then enabled to secure his raw material, manufacture and sell his goods. He is requested to place the bank in funds to meet the draft before maturity.

ACCEPTANCES SECURED BY READILY MARKETABLE GOODS IN WAREHOUSE

As a further example of this class of acceptance, let us take the case of a clothing manufacturer who desires to carry a stock of silks by means of the banker's acceptance. He places the merchandise in a warehouse, draws a draft on his bank for the value of the silk, attaching the warehouse receipts as collateral. The draft, after acceptance, is returned to him to be sold, the warehouse receipts being retained by the bank. The requirements as to warehouses in connection with bankers' acceptances will be better explained by a reference to the general statutory provisions, regulations and rulings of the Federal Reserve Board and opinions of counsel reviewed in the following pages; also the United States Warehouse Laws in Part V of this work.

It may be said, in summary, that the silk must be stored in a warehouse which is independent of the manufacturer; that is, the manufacturer must not have any control of the silk as long as the warehouse receipts are outstanding. It is, of course, possible to secure possession of the original warehouse receipts by substituting other

warehouse receipts for the silk, but if the manufacturer desires to take down the silk without substitution, he should give the bank the cash value of the silk taken, for the bank should be secured either by warehouse receipts or cash all the time its acceptance is out.

DRAFTS DRAWN FOR THE PURPOSE OF FURNISHING DOLLAR EXCHANGE

It sometimes happens that persons in foreign countries, having obligations to meet in this country, find it necessary to do so by means of dollar exchange; that is, to remit in dollars in settlement of the outstanding obligations.

The Federal Reserve Board has provided for such contingency and permission is given to banks thereby to accept drafts drawn on them by banks in certain foreign countries for the purpose of furnishing such dollar exchange. It is necessary, however, for a bank desiring to accept bills drawn for this purpose, to make application to the Federal Reserve Board for permission to do so. The restrictions surrounding acceptances for this purpose are fully set forth in the present part of the work which discusses such classes of bank acceptances.

TRADE ACCEPTANCES

A trade acceptance is a draft drawn by the seller of goods on the purchaser and accepted by him. It must bear a statement on its face to the effect that it represents a purchase of goods by the acceptor from the drawer of the draft.

Being drawn against actual current transactions and being paper bearing at least two names, preferential rates are made by Federal Reserve banks for the rediscount of trade acceptances as compared with single name paper. Such acceptances may also be purchased in the open market. If the acceptance is not paid at maturity and is properly protested, recourse may be had by the holder to any indorser and to the drawer. (For the discussion of the trade acceptance, its advantages, uses, applications, etc., see Part II of this work).

SECTION I

ACCEPTANCES BASED UPON TRANSACTIONS INVOLVING THE EXPORTATION OR IMPORTATION OF GOODS

General Statutory Provisions

Use of acceptances in foreign trade.—Any member bank is permitted to accept drafts or bills of exchange which grow out of transactions involving the exportation or importation of goods.

OPINIONS OF COUNSEL AND RULINGS

Relating to Acceptances Based Upon the Exportation or Importation of Goods

Character of transaction on which acceptances are based—Identification of specific goods not required.—Good faith must be relied upon to a large extent in determining whether an acceptance is based on a transaction involving the importation or exportation of goods. A member bank would be justified in putting on a notification, as, "this acceptance is based upon a transaction involving the importation or exportation of goods," provided it is satisfied that the statement by its customer is made in good faith.

It is not necessary that the specific goods covered by an acceptance based upon an import or export transaction be identified at the time of the acceptance.

Member banks may best protect themselves in determining whether acceptances are based upon the exportation or importation of goods by stipulating the right at times to ask for substantiation of assurances from a customer.

Transactions must involve import or export of goods, otherwise insufficient.—A transaction in order that it may be the basis of a draft or bill eligible for acceptance by a member bank, must in itself involve the importation or exportation of goods. A transaction wholly independent of the transaction covering the importation or exportation of goods is not sufficient basis for an acceptance.

Drafts treated as drawn in domestic transactions.—Where the contract between a seller of goods who draws a draft and the purchaser is entirely independent of the contract for the export of the goods, the draft would have to be treated as drawn in a domestic transaction and would have to be accompanied by shipping documents or secured by warehouse receipts or other similar documents conveying or securing title when accepted by the drawee bank.

Option to secure drafts as in domestic transactions.—A dealer having drawn drafts accepted by a member bank in an export transaction, should be given the option, with the consent of the accepting bank, to secure such drafts in the manner required of those drawn in domestic transactions if he wishes to use the proceeds derived from the sale of the goods exported for purposes other than the payment of such acceptances.

Goods ultimately intended for export insufficient basis.—Where a domestic corporation "A" enters into a contract with another domestic corporation "B" to furnish materials to be used by "B" in the manufacture of products which "B" is under contract to export, the mere fact that the material furnished is ultimately intended for export in some form cannot be said to merge the two transactions into one. The transaction between "A" and "B" could not be said to involve the exportation of goods.

Acceptance at the instance of exporter.—If a drawee bank accepts at the instance of the purchaser of goods, the purchaser having a contract to export such goods, the draft would grow out of a transaction involving the export of goods, and could be accepted by the drawee bank.

Goods purchased subsequent to acceptance.—Goods may be purchased and shipped subsequent to the time of the first acceptance, provided there is a definite bona fide contract for the shipment of the goods within a specified and reasonable time.

Acceptances against future importation of goods.—A national bank may accept a draft, drawn for the purpose of importing goods, whether or not the sale of the goods under consideration has actually been consumated at the time of the acceptance of the draft, if the accepting

bank is assured that the proceeds of the draft will ultimately be used solely for the purpose of financing a transaction involving the importation of goods. It is not necessary that the goods to be sold be identified at the time of acceptance. The accepting bank, however, must be reasonably sure that the draft is drawn for the purpose of financing a transaction involving the importation or exportation of goods, and that its proceeds will be used for that purpose.

Delay in shipment of goods is immaterial.—The fact that there is a temporary delay in actual shipment of goods is immaterial, as was held in a case of a national bank which accepted a draft drawn upon it in settlement of advances for cotton being accumulated by cotton buyers for export.

Acceptance of drafts when export contract not fulfilled.—A member bank would be justified, if fully secured, in accepting drafts drawn by a local cotton buying firm having a contract to sell to foreign buyers, if the transaction, after having been made in good faith, ultimately resulted in the sale of the cotton to an American instead of a foreign purchaser. It was assumed in this ruling that the bank had received permission from the Federal Reserve Board to accept drafts or bills of exchange drawn upon it; that the cotton buyers had a contract to sell cotton to a firm in Liverpool; that they held the cotton subject to shipping receipt of the Liverpool firm; and that because of freight rates and shipping conditions, the Liverpool firm changed its policy and directed the sale of the cotton.

Drafts drawn against collateral of acceptances.—An acceptance house which has purchased an acceptance based on the importation or exportation of goods cannot reimburse itself by drawing a bill upon a national bank, pledging as collateral security for the bill the original acceptance. The new bill cannot properly be said to grow out of the original export transaction. Such a draft drawn under the above circumstances, because it is not an acceptance growing out of a transaction involving the importation or exportation of goods, nor drawn by a bank or banker located in a foreign country, nor growing out of a transaction involving the domestic shipment or storage of goods, is ineligible.

Acceptance agreements of dealers in same goods for export and domestic sale.—Where a dealer who is engaged in the purchase of the same character and class of goods for export and for domestic purposes desires to finance the sale and purchase of the goods to be exported, his agreement with a member bank accepting such draft should show that he has a contract for the export of the goods; that the total amount of drafts under such credit will not exceed the aggregate amount involved in the export transaction; that the proceeds of the drafts are to be used in connection with the export transaction; and that the proceeds of the sale of goods exported will be applied in payment of the acceptances unless the dealer has in the meantime placed the bank in funds to meet them at maturity, or has secured such acceptances in the manner required of domestic acceptances.

Acceptances against gold coin and bullion.—Such acceptances are eligible, as gold coin and gold bars may be properly considered as goods.

MATURITY RELATING TO BANK ACCEPTANCES BASED ON IMPORTS AND EXPORTS

General Statutory Provisions

Period of maturity.—Acceptances of member banks against imports and exports are limited to drafts "having not more than six months' sight to run, exclusive of days of grace."

OPINIONS OF COUNSEL AND RULINGS

Relating to Maturity of Bank Acceptances Based on Imports and Exports

Duration of acceptance credits may exceed six months.—A national bank may enter into an agreement having more than six months to run, by the terms of which it may obligate itself for a period of time specified in the agreement to accept drafts drawn upon it, provided such drafts grow out of transactions involving the importation or exportation of goods, and the individual drafts have not more than six months' sight to run. This distinction is emphasized by the

Board in an informal ruling as follows: While a letter of credit or credit agreement may lawfully be made by a national bank which will extend by its terms for a period exceeding six months, the agreement must not be of such a character as will impose upon the holders of drafts accepted thereunder any obligation to renew such drafts so that the period of acceptance shall exceed six months in duration as to any specified draft.

Renewals of bank acceptances permitted to be made for reasonable periods.—Upon payment of an acceptance, the accepting bank may for a reasonable period accept new drafts for the financing of the original transaction, even after the shipment and delivery of the goods, provided such renewals be stipulated in the original contract as an incidental condition of the transaction of importation or exportation upon which the acceptance is based.

AMOUNT BANK MAY ACCEPT FOR ONE INTEREST

General Statutory Provisions in Connection With the Above Relating to Bank Acceptances Based on Imports and Exports

Limitation of amount; exception.—No member bank is permitted to accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation, to an amount equal at any time in the aggregate to more than ten percentum of its paid up and unimpaired capital and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance.

OPINIONS OF COUNSEL AND RULINGS

Relating to Amount Bank May Accept for One Interest on Transactions Involving Exports and Imports

Secured bills; accepting bank must remain secured.—The ten per cent. limit upon the amount of acceptances which any member bank might make for one person, firm, company, or corporation, does not apply if "the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the

acceptance." If documents, which were attached at the time of acceptance, are surrendered and no other security growing out of the same transaction is substituted, the ten per cent. limit will apply. The accepting bank must remain secured in the same manner prescribed during the life of the acceptance in order to be exempt from the ten per cent. limit.

What constitutes actual security—The only doubtful question is as to what constitutes some other actual security growing out of the same transaction as the acceptance. The ten per cent. limit does not apply where the acceptor holds (1) shipping documents, (2) warehouse receipts, or

(3) Trust receipts which do not enable the borrower to obtain the goods for his own use.

The ten per cent. limit does apply where the bank holds merely the ordinary trust receipt which gives it only a lien on the goods in the hands of the purchaser or on their proceeds.

Trust receipts as actual security.—If an acceptance is secured by shipping documents which are surrendered by the acceptor for a trust receipt which permits the purchaser of the goods to retain control of the goods, the accepting bank cannot be said to be secured by some other actual security. A trust receipt, however, which does not permit the purchaser to procure control of the goods, may properly be said to be actual security.

Effect and relation of United States Revised Statutes, Section 5200 to the ten per cent. limit; its application.—A member bank may legally purchase its own acceptance, but such a transaction is equivalent to a loan or advance to the customer for whom the acceptance is made and the liability of such customer becomes subject to the limitations of Section 5200, Revised Statutes. The limitation imposed by Section 5200 of the Revised Statutes on the amount of money which may be borrowed by any individual from a member bank does not apply to acceptances of said bank.

Acceptances in addition to loans; exception.—Where a national bank has already loaned ten per cent. of its capital and surplus to a certain company, it may, while the loan is still outstanding, obligate

itself as acceptor of a draft drawn by the same company. If, however, a member bank purchases its own acceptance, it must treat the transaction as a loan and not as an acceptance, and can not in that case lend to, and accept for, the same firm in an aggregate amount in excess of ten per cent. prescribed by Section 5200 of the Revised Statutes.

When drawer fails to provide funds to meet acceptance.—The ten per cent. limit imposed by Section 5200 of the Revised Statutes is not intended to apply to the mere acceptance of a bill of exchange, but the provision of the section would apply to the indebtedness arising between the drawer of the bill and the accepting bank in case the drawer fails to furnish funds with which to meet the acceptance at maturity.

AGGREGATE AMOUNT BANK MAY ACCEPT

General Statutory Provisions in Connection With the Above Relating to Transactions Based on the Importation or Exportation of Goods

Limitation of amount fifty per cent.—No bank is permitted to accept bills to an amount equal at any time in the aggregate to more than one-half of its unimpaired capital stock and surplus, provided, however, that the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks alike, regardless of the amount of capital and surplus, may authorize any member bank to accept such bills to an amount not exceeding at the time in the aggregate one hundred percentum of its unimpaired paid up capital stock and surplus.

REGULATIONS OF THE FEDERAL RESERVE BOARD

In Connection with Aggregate Amount Bank May Accept

Application required to be filed with Board for power to accept up to one hundred per cent.—Any member bank, having an unimpaired capital equal to at least twenty percentum of its paid up capital, which desires to accept drafts or bills of exchange up to an amount not

exceeding at any time in the aggregate one hundred percentum of its paid up capital stock and surplus, may file an application for that purpose with the Federal Reserve Board, which application must be forwarded through the Federal Reserve bank of the district in which the applying bank is located.

Report on application to be made by Federal Reserve bank to the Board.—The Federal Reserve bank is required to report to the Federal Reserve Board upon the standing of the applying bank, stating whether the business and banking conditions prevailing in its district warrant the granting of such application.

Reversal of approval.—The approval of any such application may be rescinded upon ninety days' notice to the bank affected.

OPINIONS OF COUNSEL AND RULINGS

IN CONNECTION WITH AGGREGATE AMOUNT BANK MAY ACCEPT

No requirement of permission necessary to accept up to fifty per cent.—It is not necessary to obtain the authority of the Federal Reserve Board in the case of member banks desiring to undertake acceptance business unless the bank wishes to exceed fifty per cent. of its capital and surplus.

Acceptances of correspondents under guaranty of national banks.—Drafts accepted by foreign correspondents at the request and under the guaranty of a national bank in the United States should be reported as a direct liability of such national bank and should be treated as subject to the limitations imposed by the Federal Reserve Act on the acceptance powers of national banks.

Bank purchasing own acceptances.—When a member bank purchases its own acceptances before maturity, such acceptances need not be included in the aggregate of acceptances authorized by Section 13 of the Federal Reserve Act.

Limitations of Section 5202.—The limitations imposed by Section 5202, Revised Statutes, on the liabilities incurred by any national bank do not apply to acceptances of such banks.

SUMMARY OF BANK ACCEPTANCES BASED ON IMPORTS AND EXPORTS

From the foregoing, it may be noted by way of general summary, that:

1. A member bank may not accept bills to a greater amount than fifty per cent. of its capital and surplus, unless the Federal Reserve Board has authorized it to accept to one hundred per cent.

2. The amount of domestic bills accepted shall in no event exceed fifty per cent. of capital and surplus.

3. Acceptances purchased by the accepting banks are exempt from the above limitations.

BANK ACCEPTANCES EXECUTED TO FURNISH DOLLAR EXCHANGE

General Statutory Provisions

Acceptances executed to furnish dollar exchange.—Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries, or dependencies, or insular possessions of the United States, for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies or insular possessions.

REGULATIONS OF THE FEDERAL RESERVE BOARD

In Connection With Bank Acceptances Executed to Furnish Dollar Exchange

Application for permission to accept.—Any member bank desiring to accept drafts drawn by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange must first make an application to the Federal Reserve Board setting forth the usages of trade in the respective countries, dependencies, or insular possessions in which said banks or bankers are located.

Conditions upon which approval will be made.—If the Federal Reserve Board should determine that the usages of trade in such countries, dependencies, or possessions, require the granting of the acceptance facilities applied for, it will notify the applying bank of its approval and will also publish in the Federal Reserve bulletin the name or names of those countries, dependencies, or possessions, in which banks or bankers are authorized to draw on member banks whose applications have been approved for the purpose of furnishing dollar exchange. The Federal Reserve Board reserves the right to

modify, or on ninety days' notice, to revoke its approval either as to any particular member bank or as to any foreign country or dependency or insular possession of the United States in which it has authorized banks or bankers to draw on member banks for the purpose of furnishing dollar exchange.

ANNOUNCEMENTS OF THE FEDERAL RESERVE BOARD

The purpose of this Act and the regulations made pursuant thereto was to enable the American banks to provide dollar exchange in countries where the check is not the current means of remittance in payment of foreign debts, but where the three months' banker's draft is generally used for that purpose. The banker's custom of selling three months' drafts in preference to checks originated in countries where the mail connections were irregular and the foreign exchange market was a limited one, and where it would have been difficult for him to draw in time to forward it by the same mail, whereas, in drawing the three months' draft, he would feel assured of being able to forward remittances before his obligation fell due. Such conditions do not exist between England and France and the United States. Member banks are now permitted to accept foreign drafts drawn upon them by banks or bankers in the following countries: Porto Rico, Santo Domingo, Costa Rico, Peru, Chili, Brazil, Venezuela, Argentina, Bolivia, Columbia, Ecquador, Nicarauga, Trinidad and Urugway.

It is understood in connection with the above that such drafts are to be drawn for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries.

MATURITY IN CONNECTION WITH BANK ACCEPTANCES EXECUTED TO FURNISH DOLLAR EXCHANGE

Period of maturity.—Member banks may accept drafts drawn to furnish dollar exchange having not more than three months' sight to run, exclusive of days of grace.

AMOUNT ACCEPTABLE BY ONE MEMBER BANK FOR ONE INTEREST

Limitation of per cent.—No member bank is permitted to accept drafts or bills of exchange executed to furnish dollar exchange for

any one bank to an amount exceeding in the aggregate ten percentum of the paid up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security.

AGGREGATE AMOUNT MEMBER BANK MAY ACCEPT

IN CONNECTION WITH BANK ACCEPTANCES EXECUTED TO FURNISH DOLLAR EXCHANGE

Limitation of per cent.—No member bank is permitted to accept such drafts or bills of exchange in an amount exceeding at any time in the aggregate one-half of its paid up and unimpaired capital and surplus.

OPINIONS OF COUNSEL AND RULINGS

IN CONNECTION WITH AGGREGATE AMOUNT MEMBER BANK MAY ACCEPT

Separate limits on the two classes of acceptances.—The fifty per cent. limit imposed upon the amount of drafts which a member bank may accept for the purpose of furnishing dollar exchange, is separate and distinct from, and not included in the limits imposed by Section 13, upon the amount of drafts or bills of exchange drawn against a shipment of goods or against warehouse receipts covering readily marketable staples which a member bank may accept. Member banks may, therefore, accept such bills even though their acceptances for other purposes aggregate fifty per cent. (or one hundred per cent.) of their capital and surplus. The limitations imposed by Section 5202 Revised Statutes, and the liabilities incurred by any national bank do not apply to acceptances of such banks.

BANK ACCEPTANCES BASED ON DOMESTIC SHIPMENTS OF GOODS

General Statutory Provisions

Bank acceptances in domestic trade.—Any member bank may accept drafts drawn upon it which grow out of transactions involving the domestic shipments of goods provided shipping documents conveying or securing title are attached at the time of acceptance.

OPINIONS OF COUNSEL AND RULINGS

Relating to Bank Acceptances Based on Domestic Shipments of Goods

Shipping documents.—Documents conveying or securing title which are an essential part of the transaction based on the domestic shipment of goods must be made out or endorsed so as to convey or secure title to the accepting bank.

Documents not required to be physically attached.—The fact that Section 13 provides that shipping documents should be "attached" should not be construed so as to require the documents to be physically fastened to the draft. It is sufficient if the accepting bank has possession of the documents at the time of acceptance. If placed in possession of the bank's agent and under control of the bank, such documents could clearly be considered as in its possession.

Transaction not required to involve sale of goods.—A member bank may accept a draft drawn against a shipment of goods from a corporation to its agent or bank even though no sale of the goods is involved in the transaction. In any case where a draft is drawn against a shipment of goods in a transaction which does not involve the sale of those goods, the maturity of the draft should approximate the duration of their transit. In such a case, the law contemplates that the

acceptance of the draft should be for the purpose of financing the shipment, and that it should not be by the means of furnishing a credit for any other purpose.

Acceptance must arise out of actual transaction.—A draft which has been drawn by the purchaser of the goods against a national bank is not eligible for acceptance by that bank merely because it is secured by a bill of lading covering the goods bought. The law contemplates some actual connection between the acceptance of the draft and the transaction involving the sale and shipment of the goods, that is, it is evidently intended that the draft should be drawn to finance that transaction. If a seller ships goods and mails the bill of lading to the purchaser, and on arrival of the bill of lading the purchaser draws on his own bank attaching the bill of lading as security and offers it for acceptance, the transaction is merely a straight loan to the drawer secured by a bill of lading.

Retention or release of shipping documents against acceptance.—The bank is believed to have the right, if it becomes necessary to do so, to release either the shipping document or warehouse receipt, provided the draft or drafts accepted by one person do not exceed ten per cent. of the capital and surplus of the accepting bank. This is a question, however, which should be determined by the bank itself.

Retention or release of warehouse receipts against acceptance.—It has been ruled proper for a bank not to release warehouse receipts other than in exceptional cases, this being purely a matter of agreement as between the bank and its customers. The Federal Reserve bank, in rediscounting such acceptances, may reasonably take into consideration the question of whether or not they are secured or unsecured at the time they are offered for rediscount.

MATURITY IN CONNECTION WITH BANK ACCEPTANCES BASED ON DOMESTIC SHIPMENTS OF GOODS

GENERAL STATUTORY PROVISIONS

Period of maturity.—Any member bank may accept such drafts drawn upon it having not more than six months' sight to run, exclusive of days of grace.

OPINIONS OF COUNSEL AND RULINGS

In Connection with Maturity of Bank Acceptances Based on Domestic Shipments of Goods

Duration of letters of credit.—The agreement must not be of such a character as will impose upon the holders of the drafts accepted thereunder any obligation to renew such drafts so that the period of acceptance shall exceed six months in duration as to the specified time, notwithstanding the fact that a letter of credit or credit agreement made by a national bank extends for a period of six months.

(See "Bank Acceptances Based on Imports and Exports" for "Amount Bank May Accept for One Interest").

AGGREGATE AMOUNT BANK MAY ACCEPT

Aggregate amount bank may accept up to one hundred per cent.—No bank is permitted to accept such bills to an amount equal at any time in the aggregate to more than one-half of its unimpaired and paid up capital stock and surplus, provided, however, that the Federal Reserve Board under such general regulations which it may prescribe, which shall apply to all banks alike regardless of the capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred percentum of its paid up and unimpaired capital stock and surplus, and provided further, that the aggregate of acceptances growing out of domestic transactions shall in no event exceed fifty percentum of its capital stock and surplus.

OPINIONS OF COUNSEL AND RULINGS

Relating to Aggregate Amount Bank May Accept

Bank purchasing own acceptances.—When a member bank purchases its own acceptances before maturity, such acceptances need not be included in the aggregate of acceptances authorized by Section 13.

Section 5202 inapplicable to acceptances.—The limitations imposed by Section 5202 Revised Statutes on the liabilities incurred by any national bank do not apply to acceptances of such banks.

BANK ACCEPTANCES SECURED BY WAREHOUSE RECEIPTS

General Statutory Provisions

Acceptances by member banks.—Any member bank may accept drafts or bills of exchange drawn upon it which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples.

OPINIONS OF COUNSEL AND RULINGS

Relating to Bank Acceptances Secured by Warehouse Receipts

Eligible Security

Warehouse receipts required to be issued by warehouses independent of borrower.—Warehouse receipts offered as security for bills accepted by member banks must be issued by warehouses which are independent of the borrower. Where a corporation is formed as a subterfuge for the purpose of evading the spirit of the Board's ruling, this fact should be taken into consideration by a member bank accepting the bill and by the Federal Reserve bank to which it is offered for discount.

If the borrower exercises such control over the corporation issuing the warehouse receipt as to give him control over the goods in storage, the purpose of requiring a receipt of the independent warehouseman would be defeated. The corporation issuing such rceipt must be organized in good faith as an independent corporation and its affairs must be administered by duly authorized officers and agents independent of the borrower.

Relation between warehouse corporation and borrower.—Where a separate corporation has been created and the warehouse receipts are issued by that corporation and not by the borrower, the requirements of the Board would appear to have been met. However, where both corporations have practically the same officers, the manager of the

warehouse appointed to execute the receipts should not be an employee of the borrowing company, as the Board requires that the receipts should be issued by a company independent of the borrower, and this requirement should be met in substance as well as in form.

Control of warehouse by acceptors' representatives.—An informal ruling has been made by the Board in connection with the following: A borrowing corporation takes receipts for goods and materials stored in a warehouse controlled by a separate corporation engaged solely in the warehouse business, the entire stock of which is owned by the prospective borrower. If a representative of the accepting bank is given control of the warehouse under a proper resolution of the directors of the warehouse corporation, the fact that the stock of the corporation is owned by the borrower should not prevent the acceptance of drafts secured by the warehouse receipts. It should be agreed, however, that if by any future action of the warehouse corporation an attempt is made to exercise control over the warehouse, the representative of the acceptor should have the right to move the goods and to place them in storage elsewhere at the expense of the warehouse corporation.

Warehouse receipts issued by lessee.—A can goods concern proposes to place part of its readily marketable goods and materials in storage with a lessee of part of its premises. The lessee is then to issue warehouse receipts to the owner of the goods, which receipts are to be issued as security for drafts drawn against and accepted by a member bank.

If the premises in question are actually turned over to the lessee under a bona fide lease, the lessee being independent of the borrower and having entire custody and control of the goods, there would seem to be no objection to a member bank accepting drafts against the security of warehouse receipts issued by such lessee. It should, however, be expressly understood and agreed that the borrower shall not have access to the premises except with the permission of the lessee and that he shall exercise no control of any sort over the goods against which warehouse receipts are issued. The warehouse receipts must, of course, be in form to properly convey and secure title to the bank.

Receipts of custodian of wool as a warehouse receipt.—Custodian's certificate or receipt, if issued in proper form to convey or secure title,

may be treated as a warehouse receipt and acceptance of member bank under such conditions would be eligible for rediscount. The wool in the above case was stored in buildings under control of custodian entirely independent of borrower.

INELIGIBLE SECURITY

Chattel mortgages.—Drafts or bills of exchange drawn in domestic transactions against a national bank cannot be accepted when secured by a chattel mortgage on cattle, but only when accompanied by shipping documents or when secured by a warehouse receipt or other similar document conveying or security title to readily marketable staples.

While cattle may be treated as readily marketable staples, a chattel mortgage is not considered a document similar to a warehouse receipt, since the borrower retains the possession of the goods and conveys to the bank only the legal title.

Collateral notes secured by chattel mortgages.—A national bank is not authorized to accept a draft secured by collateral notes which are in turn secured by chattel mortgages on cattle.

Member banks are not authorized to accept drafts of a cattle-loan company secured by notes of the owner of the cattle, although such notes may be secured by a chattel mortgage accompanying the draft at the time of acceptance.

Bills of sale.—A bill of sale is not a receipt similar to a warehouse or terminal receipt. It is merely in substance a chattel mortgage of goods in the hands of the drawer and not a receipt for goods sold in the hands of some third party "independent of the borrower."

Security not specified.—The acceptance of a draft by a member bank against an acceptance agreement which purports to assign to the bank certain collateral security, but which does not specifically mention any security as assigned, is an ordinary accommodation acceptance and is not authorized by law.

SUBSTITUTION OF WAREHOUSE RECEIPTS

Substitution.—It is held that there is no objection to permitting mills to substitute other warehouse receipts for cotton receipts during the life of an acceptance.

MATURITY

(For maturity see "Bank Acceptances Based on Domestic Shipments of Goods").

AMOUNT BANK MAY ACCEPT FOR ONE INTEREST

(Regarding the above, see "Bank Acceptances Based on Imports and Exports").

AGGREGATE AMOUNT BANK MAY ACCEPT

(See "Bank Acceptances based on Domestic Shipments of Goods").

INVESTMENTS IN ACCEPTANCES BY MEMBER BANKS

General Statutory Provisions

U. S. Revised Statutes, Section 5200, as Amended

Ten per cent. limit on liability of any one interest to a national bank; exceptions.—The total liabilities to any association, of any person, or of any company, corporation, or firm for money borrowed, including any liabilities of a company or firm, and the liabilities of the several members thereof, shall at no time exceed ten percentum of the amount of the capital stock of such association, actually paid in and unimpaired, and ten percentum of its unimpaired surplus fund; *provided*, however, that:

1. The discount of bills of exchange drawn in good faith against actually existing values;

2. The discount of commercial or business paper actually owned by the person, company, corporation, or firm, negotiating the same; and

3. The purchase or discount of any note or notes secured by not less than a like face amount of bonds of the United States issued since April 24, 1917, or certificates of indebtedness of the United States; shall not be considered as money borrowed within the meaning of this section; but the total liabilities to any association, of any person, or of any company, corporation, or firm, upon any note or notes purchased or discounted by such association and secured by such bonds or certificates of indebtedness shall not exceed (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) ten percentum of such capital stock and surplus fund of such association.

OPINIONS OF COUNSEL AND RULINGS

In Connection with Investments in Acceptances by Member Banks

Purchase or Discount of Acceptances of Other Banks

Bills of exchange include bank acceptances.—Bills of exchange may be taken as including acceptances, since a bill does not lose its characteristics as such when accepted by the drawee.

Bills discounted before acceptance.—A bill of exchange discounted before acceptance may be said to be drawn against actually existing value only when it is accompanied by shipping documents, warehouse receipts, or other papers securing title to the goods sold.

Bills secured by shipping documents or pledge of goods.—A bill secured by shipping documents, or by the pledge of goods actually sold, might be discounted by a member bank before acceptance without being subject to the limitations imposed by Section 5200, since this would constitute a bill drawn in good faith against actually existing value.

Bills discounted after acceptance.—If the bill is discounted after acceptance it may be treated as drawn against actually existing values, if drawn against the drawee at the time of, or within a reasonable time after, the shipment or delivery of the goods sold. There must be reasonable grounds to believe, at the time the bill is drawn, that the goods are in existence in the hands of the drawee either in their original form or in the shape of the proceeds of their sale.

Acceptance discounted after removal of attached documents.—When such bill has been accepted by the drawee and the documents attached have been removed, though the direct obligation of the drawee to pay such bill at maturity may be said to be substituted for the "actual value" against which the bill was originally drawn, nevertheless, when discounted by a bona fide owner for value, its discount would not be subject to the limitations of Section 5200 since it would still come within the classification of commercial or business paper actually owned by the person negotiating the same.

Should the drawee who accepts the bill, however, attempt to discount it with a member bank it would be subject to the limitations of Section 5200 since in that case the party primarily liable would in effect borrow money from the bank on its own obligation.

Discount of acceptances as business paper.—It is held by the Board that if a firm is a bona fide owner for value of the acceptances of any particular institution and such acceptances are sold to or discounted with a member bank, the acceptances could no doubt be treated as

commercial or business paper actually owned by the party negotiating them and would therefore be excepted from the limitations imposed by Section 5200, Revised Statutes.

PURCHASE BY NATIONAL BANK OF ITS OWN ACCEPTANCES

Bank permitted to purchase its own acceptances.—A member bank may legally purchase its own acceptances, but such a transaction is equivalent to a loan or advance to the customer for which the acceptance is made and the liability of such customer becomes subject to the limitations of Section 5200 of the Revised Statutes.

Exemptions from limitations of Section 13.—When a bank purchases its own acceptances before maturity, such acceptance need not be included in the aggregate of acceptances authorized by Section 13.

Reissue of acceptances.—When a bank buys its own acceptances, they are to be recorded as loans subject to the limitations of Section 5200 and the right of the bank to resell or reissue such acceptances, is, in the opinion of counsel, fully recognized by the authorities and where this is done, they may be treated as acceptances outstanding and not as loans.

Rediscount of such acceptances.—An acceptance which has been purchased by the accepting bank and subsequently rediscounted with its Federal Reserve bank is not subject to the limitations of Section 5200 of the Revised Statutes.

SYNDICATE ACCEPTANCE CREDITS

Policy of Federal Reserve Board.—The Federal Reserve Board has issued a memorandum stating its policy in dealing with acceptances drawn under credits extending over a period of one or two years, which is reviewed in the following.

Authorization; duration of credits; rate; character; approval of Federal Reserve Board.—In this memorandum, the Board authorized the banks, during a period which may be declared ended at any time, to proceed upon certain principles which may be summed up as follows:

1. Acceptance credits open for periods in excess of ninety days should only, in exceptional cases, extend over a period of more than one year, and in no case for a time exceeding two years.

2. Banks which are members of groups opening these credits should not buy their own acceptances, and where an agreement is made with the drawer for the purchase of acceptances for future delivery, the rate should not be a fixed one, but should be based upon the rate ruling at the time of the sale.

3. Transactions covered by these credits should be of a legitimate commercial nature, and acceptances must be eligible according to the rules and regulations of the Board.

4. Whenever syndicates are formed for the purpose of granting acceptance credits for more than moderate amounts, Federal Reserve banks should be consulted with regard to the transaction. The question of eligibility, both from the standpoint of the character of the goods and of the amount involved, will be passed upon by the Federal Reserve bank, subject to the approval in each case of the Federal Reserve Board.

Quantity as well as quality the controlling factors.—It must be understood, in passing upon these transactions, that not only quality but also quantity must be the controlling factors. The aggregate of these acceptances should not be permitted to constitute the greater portion of outstanding acceptances at any time, and it must be under-

stood that while the Federal Reserve banks and the Federal Reserve Board might look with favor upon a transaction as long as the total amount involved is not excessive, transactions of exactly the same character may be ruled out whenever the aggregate amount of outstanding acceptances of this character becomes in the opinion of the Federal Reserve Board, unduly large.

COMMERCIAL BANKING AND CREDITS

OPEN MARKET TRANSACTIONS IN ACCEPTANCES, BILLS OF EXCHANGE AND CABLE TRANSFERS

SECTION II

OPEN MARKET TRANSACTIONS IN ACCEPTANCES, BILLS OF EXCHANGE AND CABLE TRANSFERS

General Statutory Provisions

Cable transfers, bank acceptances and bills of exchange.—Any Federal Reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange, of the kinds and maturities by the Federal Reserve Act made eligible for rediscount, with or without the indorsement of a member bank.

Commercial bills.—Every Federal Reserve bank shall have power to purchase from member banks and to sell with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinafter defined. (See General Regulations and Rulings, following).

GENERAL REGULATIONS AND RULINGS

Relating to Open Market Transactions

Conditions governing eligibility.—The Federal Reserve Board, exercising its statutory right to regulate the purchase of bills of exchange and acceptances, has determined that a bill of exchange or acceptance to be eligible for purchase by Federal Reserve banks,

(a) Must not have been issued for carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States;

(b) Must not be a bill the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as

land, buildings, or machinery, or for investments of a merely speculative character;

(c) Must have been accepted by the drawee prior to purchase by a Federal Reserve bank unless it is accompanied and secured by shipping documents or by a warehouse, terminal or other similar receipt conveying or security title;

(d) May be secured by the pledge of goods, wares, merchandise, or agricultural products, including live stock, provided it is otherwise eligible.

In addition to the above general requirements, each bill of exchange and trade acceptance purchased under the terms of this regulation must also conform to the following:

To be eligible for purchase, the bill must have arisen out of an actual commercial transaction, domestic or foreign; that is, it must be a bill which has been issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used or are to be used for the purpose of producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution. It must have a maturity at time of purchase of not more than ninety days, exclusive of days of grace.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO OPEN MARKET TRANSACTIONS

Promissory notes not included.—Regarding the eligibility of promissory notes, the Federal Reserve Board has reached the conclusion, in which it is sustained by opinion of counsel, that promissory notes, even though bearing an additional indorsement, must be regarded as excluded from open market purchases.

Eligible paper.—There remain, therefore, as eligible for purchase, "cable transfers" and "bills of exchange," the latter being of two kinds, first, so-called foreign bills of exchange, and second, domestic acceptances drawn by one party on another, as for instance, by a seller of goods upon the purchaser, giving rise to a trade acceptance, either accepted or not accepted at the time of purchase. Whether the Federal Reserve banks should engage in such open market transactions rests entirely with them and not with the Federal Reserve Board.

Banks are cautioned that no bill be bought in the open market, which, if indorsed by a member bank, would otherwise be ineligible for rediscount under Section 13 of the Federal Reserve Act. (See General Regulations and Rulings, preceding).

Promissory notes not eligible.—Promissory notes, as distinguished from bills of exchange, whether of one or more names, are not eligible for such purchase.

Eligibility of commodity paper.—The purchase of commodity loans from member banks without their indorsement would not come within the provisions of the law unless there is two name commodity paper or such paper can be created in connection with commodity loans.

TRANSACTIONS IN BANK ACCEPTANCES IN THE OPEN MARKET

Definition of bankers' acceptances.—A banker's acceptance is a bill of exchange, of which the acceptor is a bank or trust company, or a firm, person, company, or corporation, engaged in the business of granting bankers' acceptance credits.

ELIGIBLE BANK ACCEPTANCES

General Statutory Provisions

Cable transfers and bankers' acceptances.—Any Federal Reserve bank may purchase and sell cable transfers and bankers' acceptances of the kinds and maturities by the Federal Reserve Act made eligible for rediscount, with or without the indorsement of a member bank. (See Regulations following).

REGULATIONS OF THE FEDERAL RESERVE BOARD

Conditions governing eligibility.—To be eligible for purchase, the bill must have been drawn under a credit open for the purpose of conducting or settling accounts resulting from a transaction or transactions involving:

(1) The shipment of goods between the United States and any

foreign country, or between the United States and any of its dependencies or insular possessions or between foreign countries;

(2) The shipment of goods within the United States, provided the bill at the time of its acceptance is accompanied by shipping documents;

(3) The storage within the United States of readily marketable goods, provided the acceptor of the bill is secured by warehouse, terminal or other similar receipt;

(4) The storage within the United States of goods which have been actually sold, provided the acceptor of the bill is secured by the pledge of such goods;

(5) It must be a bill drawn by a bank or banker in a foreign country, or dependency, or insular possession of the United States, for the purpose of furnishing dollar exchange. The bank or banker in the latter case drawing the bill must be in a country, dependency, or possession, whose usages of trade have been determined by the Federal Reserve Board to require the drawing of bills of this character.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO ELIGIBLE BANK ACCEPTANCES

Accepted commercial paper secured by bullion shipments.—Gold bars may be considered as goods, and, therefore, sixty day bills, when accepted by banks and bankers against such shipments, would be eligible for purchase by Federal Reserve banks as based upon or involving the exportation of goods. Gold coin may also be properly considered as goods, and, therefore, a bill of exchange drawn to finance a shipment of gold coin from this country is eligible for purchase by a Federal Reserve bank if otherwise in conformity with the provisions of the law and the regulations of the Federal Reserve Board.

INELIGIBLE BANK ACCEPTANCES

OPINIONS OF COUNCIL AND RULINGS

Acceptances not based on sales and not secured, ineligible.—Acceptances which are drawn by a manufacturer and accepted by a trust company, not a member of the Federal Reserve System, the proceeds

of which are to be used for purchases of raw material and payment for labor, where the goods have not been sold, and no warehouse receipts or other instruments could be furnished, are held not to be eligible for purchase by a Federal Reserve bank.

Acceptances secured by bill of sale ineligible.—A banker's acceptance drawn for the purpose of purchasing goods secured by a bill of sale of stock in hand is not eligible for purchase by Federal Reserve banks.

Bills payable outside the United States ineligible.—Under the regulations of the Federal Reserve Board defining bankers' acceptances. any bill which is payable elsewhere than in the United States would not be eligible for purchase as a banker's acceptance, even though eligible in all other respects, but might, however, be purchased as a bill of exchange payable in a foreign country.

EVIDENCE OF ELIGIBILITY AND REQUIREMENT OF STATEMENTS

Regulations of the Federal Reserve Board

Evidence of eligibility; exception of bills accepted by national banks. A Federal Reserve bank must be satisfied either by reference to the acceptance itself, or otherwise, that it is eligible for purchase. Satisfactory evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal Reserve bank. No evidence of eligibility is required with respect to a bill accepted by a national bank.

Requirement of statements.—Bankers' acceptances, other than those accepted or indorsed by member banks, shall be eligible for purchase only after the acceptor has furnished a satisfactory statement of financial condition in form to be approved by the Federal Reserve Board, and has agreed in writing with a Federal Reserve bank to inform it upon request concerning the transactions underlying such acceptances.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO EVIDENCE OF ELIGIBILITY AND REQUIREMENT OF STATEMENTS

Responsibility for eligibility; statement required to be satisfactory in form.—Ultimate responsibility in purchasing acceptances is held to rest with Federal Reserve banks. The announcement that the Federal Reserve Board will require statements satisfactory to it in connection with acceptances is held to mean that the statement shall be satisfactory in form.

MATURITY

GENERAL STATUTORY PROVISIONS

Maturity.—Any Federal Reserve bank may purchase and sell cable transfers and bankers' acceptances of the kinds and maturities made eligible for rediscount by the Federal Reserve Act.

REGULATIONS OF THE FEDERAL RESERVE BOARD

Requirements as to maturity.—To be eligible for purchase, the bill must have a maturity at the time of purchase of not more than three months, exclusive of the days of grace.

TRANSACTIONS IN BILLS OF EXCHANGE AND TRADE ACCEPTANCES

Definition of bill of exchange.—The regulations of the Federal Reserve Board define a bill of exchange to be an unconditional order in writing, addressed by one person to another, other than a banker, signed by the person giving it, requiring the person to whom it is addressed to pay, in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person.

Definition of trade acceptance.—A simple definition of a trade acceptance would be a bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser.

ELIGIBLE BILLS AND TRADE ACCEPTANCES

GENERAL STATUTORY PROVISIONS

Eligible bills.—Any Federal Reserve bank may purchase and sell in the open market bills of exchange of the kinds and maturities made eligible for rediscount by the Federal Reserve Act. (See Regulations following).

REGULATIONS OF THE FEDERAL RESERVE BOARD

General conditions of eligibility.—A bill of exchange or acceptance to be eligible for purchase by Federal Reserve banks, (1) must have been accepted by the drawee prior to purchase by a Federal Reserve bank unless it is accompanied and secured by shipping documents, or by a warehouse, terminal or other similar receipt conveying or securing title;

(2) May be secured by the pledge of goods, wares, merchandise or agricultural products, including live stock, provided it is otherwise eligible. Each bill of exchange and trade acceptance purchased must also, in addition to the above requirements, conform to the more specific requirements set forth in the following:

To be eligible for purchase, bills must have arisen out of an actual commercial transaction, domestic or foreign; that is, it must be a bill which has been issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used or are to be used for the purpose of producing, purchasing, carrying or marketing goods in one or more of the steps of the process of production, manufacture or distribution, and must have a maturity at the time of purchase of not more than ninety days exclusive of days of grace.

INELIGIBLE BILLS AND TRADE ACCEPTANCES

REGULATIONS OF FEDERAL RESERVE BOARD

Finance paper.—To be eligible for purchase by Federal Reserve banks, a bill of exchange or acceptance must not have been issued for carrying on trading in stocks, bonds, or other investment securities, except bonds and notes of the government of the United States; and must not be a bill the proceeds of which have been used or are to be

used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for investments of a merely speculative character.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO INELIGIBLE BILLS AND TRADE ACCEPTANCES

Drafts drawn on corporation by agent ineligible.—Instruments in the form of bills of exchange, drawn by an agent of a corporation upon the corporation itself, are not bills of exchange, such as are eligible for purchase in the open market by Federal Reserve banks.

Paper stamped "trade acceptance" of no value as such.—The fact that a land company has stamped a bill a "trade acceptance" and has accepted such bill does not in itself make it a trade acceptance.

EVIDENCE OF ELIGIBILITY AND REQUIREMENT OF STATEMENTS

REGULATIONS OF FEDERAL RESERVE BOARD

Evidence of eligibility; requirement of statements.—A Federal Reserve bank shall take such steps as it deems necessary to satisfy itself as to the eligibility of the bill offered for purchase unless it presents prima facie evidence thereof or bears a stamp or certificate affixed by the acceptor or drawer showing that it is a trade acceptance. A bill is not eligible for purchase unless indorsed by a member bank, and in case there is no indorsement by such member bank, a satisfactory statement of the financial condition of one or more of the parties thereto must be furnished.

MATURITY

GENERAL STATUTORY PROVISIONS AND REGULATIONS OF THE FEDERAL RESERVE BOARD

Any Federal Reserve bank may purchase and sell bills of exchange of the kinds and maturities by the Federal Reserve Act made eligible for rediscount, and in any case, such maturities must not exceed ninety days, exclusive of days of grace, at the time of purchase.

COMMERCIAL BANKING AND CREDITS

ADVANCES BY
FEDERAL RESERVE BANKS

SECTION III

COMMERCIAL BANKING AND CREDITS

Advances By Federal Reserve Banks

1. General Statutory Provisions.
2. Security.
3. Maturity.

General Statutory Provisions

Maturity; security; eligible paper; U. S. obligations.—Any Federal Reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days, at rates to be established by such Federal Reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal Reserve banks under the provisions of the Federal Reserve Act, or by the deposit or pledge of bonds or notes of the United States.

SECURITY

Advances on bonds or notes of the United States.—Any Federal Reserve bank may make advances to member banks on their promissory notes, secured either by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or purchase by Federal Reserve banks, or by the deposit or pledge of bonds or notes of the United States.

OPINIONS OF COUNSEL AND RULINGS

Relating to Security on Advances by Federal Reserve Banks

Indorsement of collateral.—Eligible paper pledged as security for a promissory note of a member bank on which an advance is being made by a Federal Reserve bank need not be indorsed by such member bank if such eligible paper is already in negotiable form.

Collateral of Government bonds.—Any member bank which has itself purchased obligations of the United States may procure advances from its Federal Reserve bank for not exceeding fifteen days on its own promissory note, provided such note is secured by a deposit or pledge of bonds or notes of the United States.

County warrants ineligible.—County warrants are not eligible as security for advances by Federal Reserve banks. Member banks, in procuring advances from Federal Reserve banks on promissory notes, must secure such notes by paper eligible for rediscount, or for purchase by Federal Reserve banks, or by bonds or notes of the United States.

Farm loan bonds ineligible.—Farm loan bonds being issued by Federal farm land banks, which are incorporated under Federal law, are not obligations of the United States, and are, therefore, not eligible as collateral for promissory notes of member banks.

For conditions governing eligibility of acceptances, drafts and notes, see "Rediscount of promissory notes; eligible drafts and trade acceptances; eligible agricultural paper; eligible commodity paper; eligible bank acceptances."

MATURITY

General Statutory Provisions

Period for which advances may be made.—Any Federal Reserve bank may make advances to its member banks on their promissory notes for periods not exceeding fifteen days.

OPINIONS OF COUNSEL AND RULINGS

Notes due on Sunday or legal holiday.—If by reason of a State law, paper falling due on Saturday or Sunday must be collected one or two days before its apparent maturity or one or two days thereafter, interest should be charged accordingly.

Renewals.—Renewals may properly be made by Federal Reserve banks on fifteen day notes of the member banks if properly secured,

provided that the Federal Reserve bank does not obligate itself in advance to make any such renewal.

An informal ruling of the Federal Reserve Board in connection with renewals is to the effect that the Federal Reserve Board does not wish to prohibit the renewal of fifteen day notes but feels that renewals should be the exception rather than the rule.

COMMERCIAL BANKING AND CREDITS

REDISCOUNTS OF ACCEPTANCES, DRAFTS AND BILLS OF EXCHANGE WITH THE FEDERAL RESERVE BANKS

SECTION IV

COMMERCIAL BANKING AND CREDITS

Rediscounts With Federal Reserve Banks of Acceptances, Notes and Bills of Exchange

General Statutory Provisions

Rediscount of notes, drafts, bills of exchange, commercial, agricultural and commodity paper.—Notes, drafts and bills of exchange may be discounted by member banks of the Federal Reserve System with Federal Reserve banks, governed by the following provisions:

Upon the indorsement of any of its member banks, which shall be a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, any Federal Reserve bank may discount notes, drafts and bills of exchange arising out of actual commercial transactions; that is, notes, drafts and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount. Notes, drafts and bills of exchange secured by staple agricultural products, or other goods, wares or merchandise, are also to be considered as eligible for discount.

Classes of ineligible paper.—Notes, drafts or bills covering merely investments or issued or drawn for the purpose of carrying on trading in stocks, bonds, or other investment securities, except bonds and notes of the government of the United States, are ineligible.

Maturity of eligible paper.—Notes, drafts and bills admitted to discount must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace. Notes, drafts and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets

of the Federal Reserve bank to be ascertained and fixed by the Federal Reserve Board.

Amount rediscountable by one bank for any one interest.—The aggregate amount of such notes, drafts and bills bearing the signature or indorsement of any one borrower, whether a company, person, firm, or corporation, rediscountable for any one bank, shall at no time exceed ten per cent. of the unimpaired capital and surplus of the bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Bank acceptances eligible for rediscount.—Any Federal Reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank. Such acceptances may:

(1) Grow out of transactions involving the importation or exportation of goods;

(2) Grow out of transactions involving the domestic shipment of goods, provided shipping documents conveying or securing title are attached at the time of acceptance;

(3) Must be secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title, covering readily marketable staples;

(4) Arise out of the drawing of drafts or bills of exchange issued for the purpose of furnishing dollar exchange.

Rediscounts for member State banks.—No Federal Reserve bank is permitted to discount for any (member) State bank or trust company notes, drafts, or bills of exchange, of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per cent. of the capital and surplus of such State bank or trust company, but the discount of bills of exchange drawn against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money.

Conditions attached to rediscounts by Federal Reserve banks.—Federal Reserve banks, as a condition of the discount of notes, drafts and

bills of exchange, for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of ten per cent. of the unimpaired capital and surplus of such bank, and will not be permitted to become liable in excess of this amount while such notes, drafts and bills of exchange are under discount with the Federal Reserve banks.

Discounts for non-members.—No member bank is permitted to act as the medium or agent of a non-member bank in applying for or receiving discounts from a Federal Reserve bank, except by permission of the Federal Reserve Board.

Discounts and rediscounts subject to regulations of Federal Reserve Board.—The discount and rediscount and the purchase and sale by any Federal Reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by the Federal Reserve Act, are subject to such restrictions, limitations and regulations as may be imposed by the Federal Reserve Board.

Applications for rediscount; requirement of certificate of member bank.—All applications for the rediscount of notes, drafts, or bills of exchange must contain a certificate of the member bank, in form to be prescribed by the Federal Reserve bank, that, to the best of its knowledge and belief, such notes, drafts, or bills of exchange have been issued for one or more of the purposes governing eligibility as set forth in the regulations of the Federal Reserve Board.

REDISCOUNT OF PROMISSORY NOTES

Definition of promissory note.—A promissory note is defined as an unconditional promise, in writing, signed by the maker, to pay, in the United States, at a fixed or determinable future time, a sum certain in dollars to order or to bearer.

CLASSES OF NOTES ELIGIBLE

General Statutory Provisions

Commercial paper; definition of eligible notes.—Eligible notes are defined in the law as follows: Notes, drafts and bills of exchange

issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used or are to be used for such purposes. The Federal Reserve Board has the right to determine or define the character of the paper thus eligible for rediscount.

Agricultural and commodity paper.—Notes, drafts and bills of exchange secured by staple agricultural products, or other goods, wares, or merchandise, are eligible for rediscount.

Paper based on United States obligations.—Notes, drafts, or bills issued or drawn for the purpose of carrying on trading in bonds and notes of the government of the United States are included in the classes of promissory notes eligible for rediscount.

REGULATIONS OF THE FEDERAL RESERVE BOARD

Relating to Eligible Classes of Promissory Notes

Definition of commercial paper eligible for rediscount.—The Federal Reserve Board, exercising its statutory right to define the character of a note, draft, or bill of exchange eligible for rediscount at a Federal Reserve bank, has determined that it must be a note, draft, or bill of exchange, the proceeds of which have been used or are to be used in producing, purchasing, carrying or marketing goods, wares, or merchandise in one or more of the steps of the process of production, manufacture or distribution. The paper may be secured by the pledge of goods or collateral provided it is otherwise eligible.

OPINIONS OF COUNSEL AND RULINGS

Relating to Eligible Classes of Promissory Notes

Loans to individuals.—Federal Reserve banks do not make loans directly to individuals, but rediscount the paper of member banks which include all national banks and such State banks which may have joined the Federal Reserve System.

Notes Based on Production and Distribution of Goods

Paper of waterworks company.—The ninety day paper of a waterworks company, the proceeds of which have been used, or are to be

used to provide funds for pay-roll, purchases of coal, etc., is eligible for rediscount by a Federal Reserve bank if the paper otherwise conforms to the law and the provisions of the Board's regulations.

Notes of farmers.—Farmers' notes, the proceeds of which are to be used for tilling farms or for draining land already in use as farm land, should be classified as agricultural paper and are eligible for rediscount.

Assignment of open accounts ineligible.—The assignment of an open account is not negotiable paper and is therefore not eligible for rediscount by a Federal Reserve bank.

Discount of renewal notes.—In an informal ruling of the Federal Reserve Board, the following is mentioned in connection with the discount of renewal notes: Self-liquidating paper, even though the transaction which gives rise to it does not liquidate itself within the ninety day maturity, might be discounted even though it appears to be renewal paper. Banks should not enter into an agreement for a renewal, and care should be exercised in examining such paper, and the transactions which give rise to it, but mechanical rules should not be allowed to take the place of discriminating banking judgment.

Secured notes; eligibility tested by use of funds.—The eligibility of a note for rediscount is determined by the use of the funds derived from the original negotiation of the note. The collateral security of the note may indicate its use, but the form of collateral is otherwise immaterial. A note may, therefore, be secured by railroad stocks and bonds, but the proceeds might be used for agricultural, industrial or commercial purposes, in which event the note would be eligible for rediscount, although it would not be so if the proceeds were used to purchase or carry the railroad stocks and bonds.

Notes secured by collateral.—Notes secured by collateral, the proceeds of which have been used or are to be used for commercial purposes, and which otherwise comply with the regulations, are eligible for rediscount. The fact that commercial paper has the additional security of collateral in no way affects its eligibility for rediscount

Collateral of mortgages.—A note, draft, or bill of exchange, drawn for commercial purposes and otherwise eligible for rediscount is not rendered ineligible merely because it is secured by a mortgage on real estate.

Paper secured by bills receivable.—The note of a manufacturer secured by his bills receivable is desirable paper, and is not debarred as a collateral trust note.

Eligible security not sufficient.—A note, even though secured by eligible paper, is not itself eligible for rediscount, unless issued for an agricultural, commercial or industrial purpose.

Offerings considered upon their merits; rediscounts for insolvent banks.—A Federal Reserve bank is not obliged to give assurance to a receiver of an insolvent member bank that it will upon the reopening of the insolvent bank rediscount its eligible paper freely, without requiring the indorsement of directors or other additional sescurity.

Notes secured by food products.—Paper secured by staple perishable food products, such as butter, cheese, eggs, poultry, frozen fish, etc., carried for reasonable periods, in cold storage, on negotiable warehouse receipts, is eligible, if offered with the indorsement of a member bank at the usual rate for ninety day commercial paper.

Notes secured by pig-iron.—The note of a furnace company, secured by pig-iron, manufactured by the company on contract for delivery, is eligible for rediscount, but the Federal Reserve bank upon being offered such paper may scrutinize each case according to its merits.

Notes based on United States obligations.—A Federal Reserve bank may discount a note, draft, or bill of exchange, indorsed by a member bank, which is issued or drawn for the purpose of carrying on trading in bonds or notes of the United States. The statement of law that the definition of eligible paper shall not include notes, drafts or bills of exchange drawn for the purpose of carrying on trading in stocks, bonds or other government securities, except bonds and notes of the

government of the United States, is equivalent to an affirmative declaration of the eligibility of such notes based on United States obligations. Any member bank which has loaned money to any of its customers for the purpose of carrying on trading in bonds or notes of the United States may rediscount with its Federal Reserve bank the bill or note of its customer, provided such bill or note conforms to the following conditions governing eligibility:

(1) Has a maturity at the time of discount of not more than ninety days, exclusive of days of grace;

(2) Has the indorsement of the member bank.

Such bill or note, however, need not necessarily be secured and need not be drawn for a commercial purpose other than for the purpose of carrying on trading in notes or bonds of the United States.

Relation of maturity to eligibility.—A member bank, acting through another member bank, may obtain the discount of its paper, secured by government bonds, for a period as long as ninety days, although a member bank acting alone may not tender its collateral note to the Federal Reserve bank which runs for more than fifteen days. A country bank which has regular dealings with a large bank in a city may send its note secured by government bonds to that bank, and the Board would regard the note as eligible for rediscount by the city bank.

Notes of non-member banks.—If the proceeds of a note have been used or are to be used to carry on trading in United States obligations, the note, if acquired in good faith, should be eligible for rediscount with the indorsement of the member bank, whether it is executed by a member bank or by a non-member bank.

CLASSES OF NOTES INELIGIBLE

General Statutory Provisions

Security paper ineligible.—Eligible paper shall not include notes, drafts or bills covering merely investments or issued or drawn for the purpose of carrying on trading in stocks, bonds or other investment securities, except bonds and notes of the United States.

REGULATIONS OF FEDERAL RESERVE BOARD

RELATING TO INELIGIBLE CLASSES OF PROMISSORY NOTES

Notes for permanent, fixed or speculative investments.—A note, draft, or bill of exchange, the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as lands, buildings, or machinery, are ineligible. The paper must also not be a note, draft, or bill of exchange, the proceeds of which have been used or are to be used for investments of a purely speculative character.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO INELIGIBLE CLASSES OF PROMISSORY NOTES

RENEWALS AND EXTENSIONS

Discount of renewal notes.—Banks should not enter into an agreement for renewal. Banking judgment is necessary in determining the merits of each renewal. Those providing working capital or to finance fixed investments are not eligible for rediscount.

Extension of time.—A note or draft containing a provision for an extension of time should not be approved for general use by the Federal Reserve Board.

Financial paper; notes to replace funds withdrawn ineligible.—A note executed by one bank and discounted by another, the proceeds of which were used to replace funds withdrawn by customers to purchase liberty bonds is not eligible for rediscount by a Federal Reserve bank, since the proceeds were not used for an agricultural, industrial or commercial purpose or for the purchase of notes or bonds of the United States.

Paper secured by War Savings Stamps.—Notes, drafts and bills of exchange which are secured by War Savings Stamps are ineligible for rediscount with a Federal Reserve bank. It is suggested by counsel that War Savings Stamps are not bonds or notes of the Unites States, but in effect only receipts for payment on account of non-negotiable evidences of indebtedness.

Notes of finance companies.—The note of a finance or credit company which is either drawn directly or indirectly to finance some industrial or commercial concern in the transaction of its business is not eligible for rediscount, even though it may be secured by paper which is itself eligible for rediscount.

Notes of acceptance houses or brokers.—The note of an acceptance house or broker, secured by acceptances eligible for rediscount at a Federal Reserve bank, is not eligible for rediscount. Such note of the acceptance house or broker cannot be said to have been used for an industrial, agricultural or commercial purpose, since the business of such acceptance house or broker is not such as to come within any of these classifications. The fact that the note is secured by eligible paper is immaterial if the proceeds are not used for one of the purposes named.

Collateral trust notes undesirable.—Collateral trust notes are considered by the Board as not arising out of commercial transactions, and Federal Reserve banks are, therefore, directed not to accept such for rediscount.

Collateral of bills receivable.—The note of a manufacturer, secured by his bills receivable, is desirable paper, and should not be debarred as a collateral trust note. However, if such collateral of bills receivable is issued for the purpose of carrying collateral for a speculative purpose or collateral in the nature of stocks and bonds other than the securities of the United States, the note would be ineligible for rediscount.

BILLS PAYABLE WITH COLLECTION CHARGES

Exchange and collection charges distinguished.—A bill made payable with collection charges is not a negotiable instrument, though the negotiable instruments law provides that an instrument payable with exchange does not lose its negotiability. Exchange is usually ascertainable in advance while collection charges are not so ascertainable.

Charges before and after maturity.—A bill containing a provision for payment of the cost of collection and attorney's fees if it is dis-

honored at maturity is a valid negotiable instrument. It must be drawn so as to show that no collection charges are to be included unless the bill is dishonored at maturity.

EVIDENCE OF ELIGIBILITY

AND

REQUIREMENT OF STATEMENTS

REGULATIONS OF THE FEDERAL RESERVE BOARD

Evidence of eligibility.—A Federal Reserve bank must be satisfied by reference to the note or otherwise that it is eligible for rediscount. Compliance of a note may be evidenced by a statement of the borrower showing a reasonable excess of quick assets over current liabilities. The member bank shall certify in its application whether the note offered for rediscount has been discounted for a depositor or for another member bank, or whether it has been purchased for a non-depositor. It must also certify whether a financial statement of the borrower is on file.

Financial statements.—Such financial statements must be on file with respect to all notes offered for rediscount, which have been purchased from sources other than a depositor or a member bank. With respect to any other note offered for rediscount, if no statement is on file, a Federal Reserve bank can use its discretion in taking the steps necessary to satisfy itself as to eligibility. It is authorized also to waive the requirement of a statement with respect to any note discounted by a member bank for a depositor or another member bank, in accordance with the following:

(1) If it is secured by a warehouse, terminal or other similar receipt covering goods in storage;

(2) If the aggregate of obligations of the borrower rediscounted and offered for rediscount at the Federal Reserve bank is less than a sum equal to ten per cent. of the paid in capital of the member bank and does not exceed Five Thousand Dollars.

OPINIONS AND RULINGS

Relating to Evidence of Eligibility and Requirement of Statements

Paper of cotton mills.—Authorization is given to banks to discount paper of cotton mills indorsed by member banks where general conditions are satisfactory, and where the statement of the cotton mill indicates that the plant is not mortgaged and that the deficiency between capital and plant account does not amount to more than five dollars per spindle.

Unmined minerals are not regarded as quick assets; standing timber not regarded as quick assets.—The Federal Reserve Board regards it as an unsafe policy for Federal Reserve banks to treat timber standing upon tracts of land as quick assets, similar to manufactured goods in the hands of the manufacturer or jobber. The same applies to unmined minerals.

MATURITY OF NOTES ELIGIBLE FOR REDISCOUNT

General Statutory Provisions

Commercial, agricultural and live stock paper.—Notes, drafts, and bills admitted to discount under terms of this paragraph must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace, with the exception of notes, drafts and bills drawn or issued for agricultural purposes or based on live stock, which may have a maturity of not exceeding six months, exclusive of days of grace. These may be discounted in an amount to be limited to a percentage of the assets of the Federal Reserve bank to be ascertained and fixed by the Federal Reserve Board.

OPINIONS OF COUNSEL AND RULINGS

Relating to Maturity of Promissory Notes Eligible for Rediscount

Notes payable on or before a certain date.—A bill payable "on or before" a certain date is negotiable paper, and, if otherwise in conformity with the provisions of law and the Federal Reserve bank is eligible for discount with a Federal Reserve bank.

Demand notes not eligible.—A demand note or bill is not eligible since it is not in terms payable within the prescribed ninety days, but may, at the option of the holder, not be presented for payment until after that time. However, if the bill were altered so as to read "on or before ——— days from date, pay to the order of ourselves," etc., it would come within the terms of the law and would thus be made eligible for rediscount.

Notes payable before a certain date.—A note made payable "on demand, and if no demand is made, then on ———," is eligible for rediscount with a Federal Reserve bank, provided that the date to be filled in is not more than ninety days from the date of discount, and provided further it conforms to the other provisions of law and the regulations of the Board.

Extension of time on notes or drafts.—A note or draft containing a provision for an extension of time should not be approved for general use by the Federal Reserve Board.

Direct loans and discounts distinguished.—A member bank may obtain indirectly, acting through another member bank, the discount of its paper secured by government bonds for a period as long as ninety days, although a member bank acting alone may not tender its collateral to the Federal Reserve bank, which runs for more than fifteen days. It may be proper in this connection to consider questions of fact—whether the two banks exchange courtesies merely for the purpose of having their notes discounted for ninety days instead of fifteen days; but in case a country bank which has its regular dealings with a large bank in a city sends its notes secured by government bonds to that bank, the Board would regard the note as eligible for rediscount by the city bank.

REGULATIONS OF THE FEDERAL RESERVE BOARD

RELATING TO MATURITY OF PROMISSORY NOTES ELIGIBLE FOR REDISCOUNT

Maturity of notes, drafts, bills of exchange and agricultural paper.—Any Federal Reserve bank may discount for any of its member banks any note, draft, or bill of exchange, provided it has a maturity at the

time of discount of not more than ninety days, exclusive of days of grace; but if drawn or issued for agricultural purposes or based on live stock, it may have a maturity at the time of discount of not more than six months, exclusive of days of grace.

AMOUNT OF PAPER OF ONE INTEREST REDISCOUNTABLE FOR ONE MEMBER BANK

General Statutory Provisions

Limitation of amount; exception.—The aggregate of such notes, drafts and bills of exchange, bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscount for any one bank, shall at not time exceed ten percentum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Limitation of rediscounts for member State banks.—No Federal Reserve bank shall be permitted to discount for any member State bank or trust company, notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten percentum of the capital and surplus of such State bank or trust company; but the discount of bills of exchange drawn against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money.

Conditions governing discount of notes, drafts and bills of exchange for State banks or trust companies.—The Federal Reserve bank, as a condition of the discount of notes, drafts or bills of exchange for such State bank or trust company shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of ten percentum of the unimpaired capital and surplus of said bank, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal Reserve bank.

REGULATIONS OF THE FEDERAL RESERVE BOARD

IN CONNECTION WITH AMOUNT OF PAPER OF ONE INTEREST REDISCOUNTABLE FOR ONE MEMBER BANK

Ten per cent. limit and exceptions.—The aggregate of notes, drafts and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscountable for any one member bank, is not permitted at any time to exceed ten per cent. of the unimpaired capital and surplus of such bank; but this restriction does not apply to the discount of bills of exchange in good faith against actually existing value.

OPINIONS OF COUNSEL AND RULINGS

IN CONNECTION WITH AMOUNT OF PAPER OF ONE INTEREST REDISCOUNTABLE FOR ONE MEMBER BANK

Limitation of amount rediscountable.—A Federal Reserve bank is not permitted to rediscount the paper of a customer of a member State bank if the customer is indebted to such member bank in an amount in excess of ten per cent. of the capital and surplus of said bank.

Discount of paper for one maker or indorser.—If any particular paper presented by a member bank to a Federal Reserve bank for rediscount, singly or added to the paper of the same makers or indorsers, which the Federal Reserve bank has already rediscounted for said member bank, amounts to a total of more than ten per cent. of the unimpaired capital and surplus of that bank, the Federal Reserve bank has no authority for such rediscount.

Not applicable to rediscounting bank.—The limitations on the rediscount of paper bearing the signature or indorsement of any one borrower should not be held to refer to the indorsement of a non-member bank on paper rediscounted with a member bank.

Paper of cotton broker.—An opinion has been asked as to whether a cotton broker who was a depositor of a bank and financed cotton for

various mills by giving to the bank his note secured by warehouse receipts of the mills, indorsed in blank, for cotton stored in his name and properly insured, but sold to the mill for a specific amount to be paid at a specific time as per sales note attached—whether such loans taken from one broker in excess of ten per cent. of the capital and surplus of the bank would be an excess loan under the Federal Reserve Act, if the financing for each individual mill of the accepted sales note held of said mill were not in excess of ten per cent. It is held that the transaction in form is not merely a discount of single name negotiable paper secured by the cotton. Such notes would clearly come within the provisions of Section 5200 of the Revised Statutes (For Section 5200, see "Investment in Acceptances by Member Banks" in Part I, "Bank Acceptances"). No Federal Reserve bank could rediscount such notes bearing the name of one broker for an aggregate amount in excess of ten per cent. of the capital and surplus of the member bank.

LIMITATION OF AMOUNT OF COMMERCIAL OR BUSINESS PAPER REDISCOUNTABLE AND ITS RELATION TO SECTION 5200 OF THE REVISED STATUTES

Commercial or business paper.—While a member bank may acquire commercial or business paper from the same person in excess of ten per cent. of its unimpaired capital and surplus, its Federal Reserve bank cannot rediscount such paper bearing the signature or indorsement of the same person in excess of that amount. It should be noted that Section 13 of the Federal Reserve Act does not amend Section 5200 of the U. S. Revised Statutes. (For text of U. S. Revised Statutes, Section 5200, see "Investment in Acceptances by Member Banks," in Part I, on "Bank Acceptances").

Rediscounted paper not included in aggregate amount.—A note or bill rediscounted in good faith by a member bank which is no longer owned or held by the bank need not be included as a liability of the maker to the bank. Notes or bills rediscounted under an agreement to repurchase, or which are merely credited to the account of the bank offering them for rediscount are subject to the limitations of Section 5200. (For text of U. S. Revised Statutes, Section 5200, see "Investment in Acceptances by Member Banks").

AGGREGATE AMOUNT REDISCOUNTABLE FOR ONE BANK

General Statutory Provisions

Indebtedness of national bank.—No national banking association shall at any time be indebted, or in any way liable, in an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of liabilities incurred under the provisions of the Federal Reserve Act.

Rediscount subject to regulations of Federal Reserve Board.—The discount and rediscount and the purchase and sale by any Federal Reserve bank of any bills receivable and of domestic and foreign bills of exchange and of acceptances are subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

OPINIONS OF COUNSEL AND RULINGS

Relating to Aggregate Amount of Promissory Notes Rediscountable for One Bank

No limitation by law of commercial paper rediscountable.—The law places no limitation upon the amount of commercial paper which a member bank may rediscount with a Federal Reserve bank, but leaves this to the judgment of the officers of the Federal Reserve bank.

Discretion of Federal Reserve bank.—A national bank may not borrow as bills payable in excess of its capital stock, according to Section 5202 of the Revised Statutes, but under the Federal Reserve Act, it may rediscount actual items of paper in its possession to any amount in the discretion of the Federal Reserve bank in its district.

INDORSEMENT OF MEMBER BANKS

In Connection With Rediscount of Promissory Notes

General Statutory Provisions

Indorsement.—Any Federal Reserve bank may discount notes, drafts, and bills of exchange upon the indorsement of any of its mem-

ber banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively.

OPINIONS OF COUNSEL AND RULINGS

IN CONNECTION WITH INDORSEMENT OF MEMBER BANKS

Indorsement as waiver.—A simple written indorsement will be regarded as satisfactory and as coming within the terms of the law.

Effect of not bearing "without recourse."—If a note is otherwise eligible for rediscount, the fact that it bears a "without recourse" indorsement of a non-member bank will not affect its eligibility.

REDISCOUNT FOR NON-MEMBER BANK

IN CONNECTION WITH PROMISSORY NOTES

GENERAL STATUTORY PROVISIONS

Rediscounts for non-members.—No member bank shall act as the medium or agent of a non-member bank in applying for or receiving discounts from a Federal Reserve bank except by permission of the Federal Reserve Board.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO REDISCOUNT OF PROMISSORY NOTES FOR NON-MEMBER BANKS

Rediscount of paper acquired from non-member banks.—It would be necessary in each case for the officers of the Federal Reserve bank to determine whether or not the proceeds of such discounts are to be used for the purpose of making a loan to a non-member bank. If the money thus borrowed is to be relent to a non-member bank, rediscount should not be accepted without the permission of the Federal Reserve Board. If, on the other hand, a member bank had in good faith acquired from a non-member bank by rediscount, notes which are

eligible under the regulations of the Board for rediscount with a Federal Reserve bank, and such notes were held as part of the assets of the member bank, there would seem to be no objection to the Federal Reserve bank accepting such rediscounts, provided the officers are satisfied that the member bank did not extend accommodation to the non-member bank with a view of rediscounting notes so acquired with the Federal Reserve bank. This is one of the cases which must be left very largely to the judgment and discretion of the officers of the Federal Reserve bank, and the determination must be reached by them on the facts of the case.

Rediscount of paper indorsed by non-member bank.—The limitations on the rediscount of paper bearing the signature or indorsement of any one borrower should not be held to refer to the indorsement of a non-member bank on paper rediscounted with a member bank. It is true that in such case the non-member bank is contingently liable if the paper is not paid at maturity, but the Board is inclined to the view that this language refers to paper bearing the signature or indorsement of borrowers or customers of the member banks and not to the indorsement of other banks. A non-member bank could not, of course, obtain indirect accommodations from the Federal Reserve bank through the medium or agency of a member bank except with the permission of the Federal Reserve Board. But, if a member bank had acquired eligible paper in due course by rediscount from a non-member bank, the member bank should hardly be precluded from rediscounting this paper with the Federal Reserve bank because it bears the indorsement of the non-member bank.

REDISCOUNT OF DRAFTS AND TRADE ACCEPTANCES

Regulations of Federal Reserve Board

Definition of draft or bill of exchange.—A draft or bill of exchange is an unconditional order in writing, addressed by one person to another, other than a banker, signed by the person giving it, requiring the person to whom it is addressed to pay, in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO THE REDISCOUNT OF DRAFTS AND TRADE ACCEPTANCES

Extension of time for notes or drafts.—A note or draft containing a provision for an extension of time should not be approved for general use by the Federal Reserve Board.

Presentment of bills for acceptance.—The drawer and indorser of a bill of exchange made payable on the date specified in the bill are not discharged by a failure to present for acceptance, unless the bill expressly provides that it must be presented for that purpose, or unless it is payable elsewhere than at the residence or place of business of the drawee.

Acceptor not affected by waiver.—The acceptor of a bill of exchange is the principal debtor. The law requires that notice of demand and protest be given to parties secondarily liable in case of dishonor. This right to receive notice is a personal one which may be waived by the parties entitled thereto, that is, the drawer and indorser; but such waiver has no affect on the acceptor or principal debtor.

NEGOTIABILITY OF DRAFTS AND TRADE ACCEPTANCES

Effect of waivers.—The negotiability of a bill of exchange is not affected by provisions which waive demand, notice and protest; which waive homestead exemption rights; and which provide for the costs of collection and attorney's fees.

Drafts payable on condition.—A draft made "payable on arrival of car" is non-negotiable, not being payable at a determinable future time.

Drafts payable with interest.—A provision in a draft or bill of exchange that it is payable "with interest at the rate of ———% per annum after maturity, if payment is delayed," does not affect the negotiability of an instrument.

Charges before and after maturity.—A bill drawn for a fixed sum "with collection charges" is not a negotiable instrument unless it is

so drawn as to show that no collection charges are to be included unless the bill is dishonored at maturity. A bill containing a provision for payment of the costs of collection of attorney's fees if it is dishonored at maturity is a valid negotiable instrument.

Exchange and collection charges.—A bill made payable with "collection charges" is not a negotiable instrument, though the negotiable instruments law provides that an instrument payable "with exchange" does not lose its negotiability. It is suggested by counsel that the amount of exchange is usually ascertainable in advance while collection charges are not so ascertainable.

Drafts payable to order of drawee.—A bill made payable to the order of the drawee is not negotiable until the drawee as payee has indorsed it. When it has been accepted and indorsed by the payee it is a valid negotiable instrument in the hands of a third party, and the drawer is not released, since the terms of his order have been specifically complied with.

SECTION V

TRADE ACCEPTANCES

Regulations of the Federal Reserve Board

Definition.—A trade acceptance is defined in simple terms as a draft or bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser.

OPINIONS OF COUNSEL AND RULINGS

Relating to Trade Acceptances

Acceptance by drawee.—A draft to be eligible as a trade acceptance must be accepted by the drawee and not by anyone else.

Place of payment of acceptance.—An acceptance to pay at a particular place different from the residence of the acceptor is a general acceptance, unless it expressly states that the bill is to be paid there and not elsewhere, and does not render the bill non-negotiable.

Discount for prepayment.—A trade acceptance providing for a fixed discount if paid at a certain time before maturity should not be approved for general use by the Federal Reserve Board.

Discount for payment at maturity.—A trade acceptance which consists of an order to pay a certain amount which is the amount of the debt, minus a discount for prompt payment at maturity, or if not paid at maturity to pay a greater amount, which is the amount of the debt without any discount, is an order to pay a certain sum and is negotiable.

ELIGIBLE DRAFTS AND TRADE ACCEPTANCES

General Statutory Provisions

Definition of eligible paper.—Eligible paper is defined in the law as follows: Notes, drafts and bills of exchange issued or drawn for

agricultural, industrial or commercial purposes, or the proceeds of which have been used or are to be used for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount. Notes, drafts and bills of exchange, secured by staple agricultural products, or other goods, wares or merchandise, are eligible, as well as are notes, drafts or bills drawn for the purpose of carrying on trading in bonds or notes of the Government of the United States.

REGULATIONS OF FEDERAL RESERVE BOARD

RELATING TO ELIGIBLE DRAFTS AND TRADE ACCEPTANCES

Conditions governing eligibility.—The Federal Reserve Board has determined that in order for a note, draft, or bill of exchange to be eligible for rediscount, the proceeds must have been used or are to be used in producing, purchasing, carrying or marketing goods, wares and merchandise in one or more of the steps of the process of manufacturing, producing or distributing.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO ELIGIBLE DRAFTS AND TRADE ACCEPTANCES

Bills based on retail transactions.—A bill of exchange drawn by the seller of goods and accepted by the purchaser of those goods is a trade acceptance, according to the informal ruling of the Federal Reserve Board, regardless of whether or not the purchaser intends to resell the goods or to use them for his own purpose. It is, therefore, made possible for a retail dealer to finance the sale of his goods to a retail customer by means of the trade acceptance.

Bills based on sale and delivery of gas.—An acceptance drawn by a gas producing company or a gas distributing company and accepted by the latter in payment for gas sold and delivered is a trade acceptance eligible for rediscount by a Federal Reserve bank.

Bills based on installment plan sales.—The Board has ruled that if the purchaser is willing to accept a draft in advance of the delivery of

the goods, there will seem to be no reason why such an acceptance should not be treated on the same basis as a bill drawn and accepted after delivery of such goods. The above has been ruled in connection with the sale of coffee mills, etc., on the installment plan.

Drafts based on electrical installation.—Drafts drawn for the purchase price of electrical goods which include the cost of installation, may be treated as trade acceptances when such drafts are accepted by the purchaser.

Acceptances in liquidation of open account.—A bill drawn by a retail dealer on his retail customer to finance the sale of goods to that customer is a trade acceptance even if it is drawn after the purchaser has failed to remit promptly on an open account. The Board has expressed its opinion several times that the attempt to use a trade acceptance in this manner as a means of liquidating an otherwise slow account would involve considerable danger to the primary purposes of the trade acceptance movement and would subordinate the trade acceptance to the open account method, by suggesting it as a last resort for bad accounts. Trade acceptances of this character should probably be considered eligible as a matter of law. Nevertheless, member banks and Federal Reserve banks may discriminate against them, and should be encouraged to do so as far as possible.

Acceptances of sales corporations.—A draft drawn by a lumber corporation upon a sales corporation, which it and a number of other concerns have organized, will, when accepted, become a trade acceptance, even though the selling corporation is a stockholder of the sales corporation, provided the latter is organized in good faith, and not merely to act as agent for the purpose of evading the law.

Acceptances based on advertising space.—A draft or bill of exchange drawn by the seller on the purchaser of advertising space and accepted by such purchaser, is a trade acceptance. A draft or bill of exchange drawn by a publisher or other advertising agency on the purchaser of advertising space, and accepted by such purchaser, shall be considered a trade acceptance, provided the advertisement on which the draft or bill is based, is for the purpose of promoting or facilitating the production, manufacture, distribution, or sale of goods, whether mer-

chandise or agricultural products, including live stock, and provided, further, that such advertisement is not illegal and is not for the purpose of promoting or facilitating any transaction which is prohibited by the laws of the State in which it is to be consummated. These are the conditions upon which drafts drawn against advertising space sold will be ruled trade acceptances.

Acceptances based on foreign transactions; imports.—Trade acceptances originating through importations from foreign countries, which are indorsed by banks or bankers may be considered as trade acceptances, and may be taken within the range of the discount rates for bankers' acceptances.

Acceptances based on foreign transactions; exports.—Bills drawn for the purpose of providing funds for the purchase and export of cross ties and lumber are eligible for rediscount if properly indorsed and otherwise conforming to the regulation of the Federal Reserve Board. The above has been ruled in connection with exports to Cuba.

INELIGIBLE DRAFTS AND TRADE ACCEPTANCES

General Statutory Provisions

Security paper ineligible.—Notes, drafts or bills covering merely investments or issued or drawn for the purpose of carrying on trading in stocks, bonds or other investment securities, except bonds or notes of the United States Government are ineligible for rediscount.

REGULATIONS OF THE FEDERAL RESERVE BOARD

Relating to Ineligible Drafts and Trade Acceptances

Notes for permanent, fixed or speculative investments.—The paper must not be a note, draft or bill of exchange, the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings or machinery. The paper must not be a note, draft or bill of exchange, the proceeds of which have been used or are to be used for investments of a purely speculative character.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO INELIGIBLE DRAFTS AND TRADE ACCEPTANCES

Acceptances based on future purchases.—A bill, in order to be a trade acceptance, must arise out of a purchase of goods, and unless that purchase is either consummated or actually contracted for at the time the bill is drawn, it is doubtful whether it can properly be said that the obligation arises out of a purchase of goods.

Drafts in payment of insurance premiums.—A draft drawn by a casualty company against the policy holder for premiums could hardly be said to be a draft by the seller on the purchaser of goods sold and would not in the opinion of the Board come within the Board's present definition of a trade acceptance.

Drafts drawn to finance capital requirements ineligible.—The Board conceives the trade acceptance as an instrument which carries upon its face the evidence of the commercial character of the transaction which gave it birth. The finance paper of the corporation issued against drafts drawn by it on dealers and placed in trust to secure such paper issued by it in the shape of notes or certificates, gives no indication whatever as to the nature of the security, which may or may not be eligible paper. The corporation by issuing notes of this character is really raising money for capital requirements for similar transactions in the future, and the whole plan is in essence a finance operation rather than a commercial transaction.

EVIDENCE OF ELIGIBILITY

REGULATIONS OF THE FEDERAL RESERVE BOARD

Character of evidence.—A Federal Reserve bank may take such steps as it deems necessary to satisfy itself as to the eligibility of the draft or bill offered for rediscount, unless it presents prima facie evidence thereof, or bears a stamp or certificate affixed by the acceptor or drawer showing that it is a trade acceptance.

OPINIONS AND RULINGS

RELATING TO EVIDENCE OF ELIGIBILITY

Effect of stamp "trade acceptance."—It has been held several times that a bill stamped a "trade acceptance" by a land company, and signed by such party as "acceptor" does not in itself make it a trade acceptance.

MATURITY

GENERAL STATUTORY PROVISIONS

Commercial, agricultural or live stock paper.—Notes, drafts or bills admitted to rediscount must have a maturity at the time of not more than ninety days, exclusive of days of grace, provided that such notes, drafts or bills drawn or issued for agricultural purposes, or based on live stock, and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount limited to a percentage of the assets of the Federal Reserve bank, to be ascertained and fixed by the Federal Reserve Board.

REGULATIONS OF THE FEDERAL RESERVE BOARD

RELATING TO MATURITY

Period of maturity; requirements.—The draft or trade acceptance must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace, but if drawn or issued for agricultural purposes or based on live stock, it may have a maturity at the time of discount of not more than six months, exclusive of days of grace.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO MATURITY

Drafts payable on condition.—A draft made "payable on arrival of car" is non-negotiable, not being payable at a determinable future time and is, therefore, ineligible for rediscount by a Federal Reserve bank.

Drafts payable "on or before" a certain date.—Drafts payable "ninety days from date or before on five days after demand (that is, on five days' notice) by the holder hereof" are negotiable and eligible for discount with a Federal Reserve bank.

Demand drafts.—A demand note or bill is not eligible since it is not in terms payable within the prescribed ninety days, but, at the option of the holder, may not be presented for payment until after that time. If the bill were altered so as to read "on or before ——— days from date pay to the order of ourselves," etc., it would come within the terms of the law and would be eligible for rediscount.

Extension of time.—A note or draft containing a provision for an extension of time should not be approved for general use by the Federal Reserve Board.

AMOUNT OF PAPER OF ONE INTEREST REDISCOUNTABLE FOR ONE MEMBER BANK

General Statutory Provisions

Limitation as to amount and acceptance.—The aggregate of such notes, drafts and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one bank, shall at no time exceed ten percentum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the rediscount of bills of exchange drawn in good faith against actually existing items.

REGULATIONS OF FEDERAL RESERVE BOARD

On the Rediscount of Drafts and Trade Acceptances

Limitation as to amount and exception.—The aggregate of notes, drafts and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one member bank, shall at no time exceed ten per cent. of the unimpaired capital and surplus of such bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

OPINIONS OF COUNSEL AND RULINGS

ON THE REDISCOUNT OF DRAFTS AND TRADE ACCEPTANCES

Drafts discounted before acceptance.—A bill of exchange discounted before acceptance may be said to be drawn against actually existing values, when and only when it is accompanied by shipping documents, warehouse receipts or other papers securing title to the goods sold.

Trade acceptances.—An accepted bill of exchange, unaccompanied by shipping documents or other such paper may be considered as drawn against actually existing values if drawn against the drawee at the time of, or within a reasonable time after, the shipment or delivery of the goods sold. In this latter case, there must be reasonable grounds to believe that the goods are in existence in the hands of the drawee either in their original form or in the shape of the proceeds of their sale.

Trade acceptances for long standing open accounts.—A bill drawn for a balance due on open accounts of long standing, which is accepted by the debtor, might constitute a trade acceptance, but in order for it to be excepted from the limitations imposed by the Federal Reserve Act as a bill of exchange drawn against actually existing values, it must have been drawn contemporaneously with or within such a reasonable time after the shipment of the goods, as to justify the assumption that the goods are in the hands of the drawee in their original form or in the form of the proceeds of sale.

Qualified acceptances.—A bill of exchange drawn payable "at sight" and accepted payable in three months is a qualified or conditional acceptance, and the maker and prior indorsers are released. The instrument in effect becomes the promissory note of the acceptor and would not come within the exception to Section 5200 of the Revised Statutes, as a "bill of exchange" drawn in good faith against actually existing value.

Evidence of actually existing value.—As evidence of this fact, the Federal Reserve bank might reasonably require such trade acceptances as are offered "as bills of exchange drawn against actually exist-

ing values" to show the date of invoice so that it may be determined whether or not the account is one of long standing. (For further reference to the subject of rediscount of drafts and trade acceptances, see opinions and rulings relative to promissory notes; also rediscount of promissory notes affecting the aggregate amount rediscountable for one bank; indorsement of member banks; and rediscounts for non-member banks).

REDISCOUNTS BY FEDERAL RESERVE BANKS OF SIX MONTHS' AGRICULTURAL PAPER

Regulations of the Federal Reserve Board

Six months' agricultural paper defined; includes live stock.—Six months' agricultural paper is defined as a note, draft, bill of exchange, or trade acceptance, drawn or issued for agricultural purposes, or based on live stock; that is, a note, draft, bill of exchange, or trade acceptance, the proceeds of which have been used, or are to be used, for agricultural purposes, including the breeding, raising, fattening, or marketing of live stock, and which has a maturity at the time of discount of not more than six months, exclusive of days of grace.

OPINIONS OF COUNSEL AND RULINGS

Relating to the Rediscount of Six Months' Agricultural Paper

What live stock includes.—The term "live stock" is held to include not only beef cattle, but also horses and mules.

Notes of cattle dealers merely mercantile.—Notes made by mule and cattle dealers are mercantile rather than agricultural paper.

Notes of implement dealers not agricultural paper.—A note made by a dealer in agricultural implements is not agricultural paper.

Agricultural products or implements.—The purchase or sale of an agricultural product, or of implements or other commodities used in agriculture, constitutes a commercial transaction. A note made by a merchant, the proceeds of which are used to purchase seed, to be later retailed or sold, cannot be treated as given for agricultural purposes and cannot be discounted by a Federal Reserve bank, if it has a maturity at time of discount of more than ninety days.

Notes or bills of packing companies.—The bill or note of a packing company, the proceeds of which are used for the purchase of live

stock which is slaughtered upon purchase, is not "based on live stock" and is, therefore, not eligible for rediscount if it has a maturity in excess of ninety days.

ELIGIBLE AGRICULTURAL PAPER

General Statutory Provisions

Agricultural and live stock paper.—Notes, drafts and bills drawn or issued for agricultural purposes, or based on live stock, and having a maturity not exceeding six months, exclusive of days of grace, may be rediscounted in an amount to be limited to a percentage of the assets of the Federal Reserve bank, to be ascertained and fixed by the Federal Reserve Board.

REGULATIONS OF THE FEDERAL RESERVE BOARD

Relating to Eligible Agricultural Paper

Conditions governing eligibility.—To be eligible for rediscount, six months' agricultural paper, whether a note, draft, bill of exchange, or trade acceptance, must comply with the statutory provisions, regulations of the Federal Reserve Board, opinions of counsel and rulings reviewed in the subject of "Classes of Promissory Notes Eligible for Rediscount," which are the same in the case of the rediscount of drafts and trade acceptances.

OPINIONS OF COUNSEL AND RULINGS

Relating to Eligible Agricultural Paper

Cattle mortgages.—Mortgages on cattle are not required, and the question whether paper secured by cattle is self-liquidating is a legal one to be determined by the Federal Reserve Bank.

Notes for fertilizer.—A farmer's six months' note for commercial fertilizer, discounted and indorsed by a member bank, is agricultural paper eligible for rediscount with the Federal Reserve bank.

Notes for dairy cattle.—Notes signed by a farmer, the proceeds of which are used for the purchase of cows to be used as dairy cattle,

are eligible for rediscount at the discretion of the Federal Reserve bank, notwithstanding the fact that the cattle are not primarily purchased for "breeding, raising, fattening, and marketing of live stock."

Cattle for breeding, grazing or fattening.—Loans on cattle, which are used for breeding, grazing or fattening, may be made under the classification of six months' agricultural paper, and the paper may be rediscounted by a member bank at its Federal Reserve bank.

Farmers' notes.—Farmers' notes, the proceeds of which are used for tilling farms, or for draining land already in use as farm land, should be classified as agricultural paper, and are eligible for rediscount.

Notes for farm tractors.—Notes given by farmers for the purchase price of tractors where the tractors are used to supplement the work of horses or mules, or are used altogether instead of these animals, should be admitted to discount as agricultural paper when they mature within six months.

Agricultural paper, how determined.—Agricultural paper need not be directly secured by agricultural products, but should be genuinely based upon transactions entered upon for agricultural purposes. In such cases, a determination as to whether paper may be classified as agricultural or not is left to general banking prudence.

Discount by maker or indorser.—Notes given for the purchase price of a commodity can be classed as agriculture paper eligible for rediscount if they have a maturity exceeding ninety days and if the maker is to use the commodity for an agricultural purpose, regardless of whether the note is discounted by the maker or by the indorser.

Paper payable to seller of commodity.—A note may be treated as agricultural paper, whether discounted with the member bank by the farmer as the maker, or by the seller as the indorser, where the farmer makes his note payable to the seller of a commodity, and actually uses the commodity for agricultural purposes.

Paper payable to a bank.—Where the farmer makes his note payable to the member bank, and uses the proceeds for an agricultural purpose,

such a note may likewise be discounted by a Federal Reserve bank as agricultural paper. However, if the farmer does not use or intend to use the commodity purchased for an agricultural purpose, although it is capable of being so used, the note in question should be treated as commercial paper and not as agricultural paper.

Agricultural paper, how identified.—A purchasing member bank would have to satisfy itself in some satisfactory way that the bill is substantially of an agricultural character. The nature of the bill, the name of the acceptor, and the name of the drawer would probably indicate that a farmer was the purchaser, and an implement dealer the seller of the goods. As sufficient evidence of its agricultural character, a simple memorandum attached to the bill stating that the bill was drawn in payment of agricultural implements, signed either by the acceptor or the drawer, would probably be sufficient.

AMOUNT OF PAPER REDISCOUNTABLE BY FEDERAL RESERVE BANKS

General Statutory Provisions

Amount of paper rediscountable left with discretion of Federal Reserve Board.—Notes, drafts and bills of exchange, drawn or issued for agricultural purposes or based on live stock, and having a maturity not exceeding six months, exclusive of days of grace, may be rediscounted in an amount to be limited to a percentage of the assets of the Federal Reserve bank, to be ascertained and fixed by the Federal Reserve Board.

OPINIONS OF COUNSEL AND RULINGS

Relating to Amount of Agricultural Paper Rediscountable

Limit of agricultural paper rediscountable by Federal Reserve bank.—The total amount of agricultural paper purchased by a Federal Reserve bank according to law should not exceed a fixed percentage of its capital stock, to be fixed from time to time for each Federal Reserve bank by the Federal Reserve Board. The percentage fixed by the Board differs in the various districts. Whenever a district has applied, the maximum limit has been granted, which has been considered to be ninety-nine per cent. of the capital stock.

REDISCOUNT OF COMMODITY PAPER

REGULATIONS OF THE FEDERAL RESERVE BOARD

Definition of commodity paper.—Commodity paper is defined as a note, draft, bill of exchange, or trade acceptance, accompanied and secured by shipping documents, or by a warehouse, terminal, or other similar receipt covering approved and readily marketable non-perishable staples properly insured.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO THE REDISCOUNT OF COMMODITY PAPER

Definition of "staples."—Staples include manufactured goods as well as raw materials, provided the goods are non-perishable and have a wide, ready market. Included in this are cotton yarn, flour, and potatoes.

Commodity paper includes paper of merchants.—"Commodity paper" includes not only paper originating with the producer, but also paper of merchants and others when the commodity is not carried for speculative or purely investment purposes.

Drafts drawn in connection with sales to the United States Government excluded.—Drafts drawn in connection with sales to the United States Government of lumber and other materials do not conform to the requirements of commodity paper.

ELIGIBLE COMMODITY PAPER

GENERAL STATUTORY PROVISIONS

What constitutes eligibility.—Notes, drafts and bills of exchange secured by staple agricultural products, or other goods, wares, or merchandise, are eligible commodity paper.

REGULATIONS OF THE FEDERAL RESERVE BOARD

RELATING TO ELIGIBLE COMMODITY PAPER

Conditions governing eligibility.—To be eligible for rediscount at the special rates authorized to be established for commodity paper,

such a note, draft, bill of exchange, or trade acceptance, must also comply with the respective sections of this regulation applicable to it, must conform to the requirements of the Federal Reserve bank relating to shipping documents, receipts, insurance, etc., and must be a note, draft, bill of exchange, or trade acceptance on which the rate of interest or discount, including commission charged the maker, does not exceed six percentum per annum.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO ELIGIBLE COMMODITY PAPER

Direct discounts of mercantile firms not allowed.—Federal Reserve banks are not allowed to discount commodity paper directly for mercantile firms.

Drafts drawn in connection with sales to the United States Government ineligible.—Drafts drawn in connection with sales to the United States Government cannot be treated as bills of exchange, drawn against actually existing value, and are subject to the limitations imposed by Section 5200 of the Revised Statutes, when discounted by national banks. Such drafts do not conform to the requirements of commodity paper as defined by the Federal Reserve Board and should not be discounted at the rate prescribed for such paper.

SUSPENSION OF SPECIAL RATE ON COMMODITY PAPER

REGULATIONS OF THE FEDERAL RESERVE BOARD

Rate for movement of crops.—As the special rate for commodity paper is intended to assist actual producers during crop moving periods, and is not designed to benefit speculators, the Board reserves the right to suspend the special rates herein provided whenever it is apparent that the movement of crops which this rate is intended to facilitate has been practically completed.

REDISCOUNT OF BANK ACCEPTANCES

REGULATIONS OF THE FEDERAL RESERVE BOARD

Banker's acceptance defined.—A banker's acceptance is defined as a draft or bill of exchange, of which the acceptor is a bank or trust

company, or a firm, person, company, or corporation engaged in the business of granting bankers' acceptance credits.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO THE REDISCOUNT OF BANK ACCEPTANCES

Eligible acceptors, how determined.—The question of determining the eligibility of an acceptor is left to the discretion of the Federal Reserve banks themselves. The Federal Reserve Board does not wish to see concerns regarded as eligible acceptors which are not in the habit of carrying on some acceptance business regularly, and which are not generally of such character and standing as to qualify their acceptance as a "banker's acceptance."

Conditions governing negotiability.—A bill of exchange, in order to be negotiable, must be an unconditional order to pay, on demand, or at a fixed or determinable future time, a certain sum of money, to order or to bearer.

Conditional bills, what constitutes.—If payment is dependent upon the happening of a certain contingency, the bill is conditional and non-negotiable, as well as if it were confined to the proceeds of a particular fund, and not chargeable to the credit of the drawer.

Conditional acceptance.—A general acceptance of a conditional bill, or a conditional acceptance of an unconditional bill, makes the acceptance a conditional one and destroys its negotiability.

ELIGIBLE BANK ACCEPTANCES

GENERAL STATUTORY PROVISIONS

Conditions governing eligibility.—Any Federal Reserve bank may discount acceptances of the kinds described below in "Regulations of the Federal Reserve Board" which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank.

REGULATIONS OF THE FEDERAL RESERVE BOARD

RELATING TO ELIGIBLE BANK ACCEPTANCES

Maturity; indorsement; acceptances eligible for rediscount.—Any Federal Reserve bank may rediscount for any of its member banks, bankers' acceptances which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace. Such acceptances must be indorsed by at least one member bank; and must grow out of transactions:

(1) Involving the exportation or importation of goods; or

(2) Involving the domestic shipment of goods, provided shipping documents are attached at the time of acceptance; or

(3) Which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title, covering readily marketable staples;

(4) Any Federal Reserve Bank may also acquire drafts or bills of exchange drawn on member banks by banks or bankers in foreign countries or dependencies or insular possessions of the United States, for the purpose of furnishing dollar exchange. To be eligible for rediscount the bill must have been drawn under a credit opened for the purpose of conducting, or settling accounts resulting from, a transaction or transactions involving:

(1) The shipment of goods between the United States and any foreign country, or between the United States and any of its dependencies or insular possessions, or between foreign countries; or

(2) The domestic shipment of goods, provided shipping documents are attached at the time of acceptance; or

(3) It must be a bill which is secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples;

(4) Any Federal Reserve Bank may also acquire drafts or bills drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar exchange, and accepted by a member bank. Such drafts or bills may be acquired prior to acceptance provided they have the endorsement of a member bank.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO ELIGIBLE BANK ACCEPTANCES

Acceptances indorsed by member banks of another district.—Federal Reserve bank may discount acceptances based on the importation or exportation of goods, provided they have a maturity at time of discount of not more than three months, and provided, further, that they are indorsed by at least one member bank. It is immaterial whether this member bank is located in the district of the Federal Reserve bank which is making the discount or in any other district, the term "member bank" being broad enough to include member banks wherever located.

Discount of acceptances not paid at Federal Reserve bank.—Acceptances, when due, should be paid by checks on the local Federal Reserve bank in order that they may be charged to the account of the acceptor on the day of maturity, or else that acceptances should be paid by checks through the clearings. Federal Reserve banks may, therefore, charge discount for one additional day, except in cases where satisfactory arrangements are made to make actual cash payments at the Federal Reserve bank on the day of maturity.

Paper of acceptance corporation.—Acceptances of an acceptance corporation ought to be dealt with exactly as would be the acceptances of a prime private banker. These acceptance corporations are in the same relation to the Federal Reserve System as the private bankers. They cannot become members, but, inasmuch as they expect to give full information about their own financial standing and the nature of their acceptances, and as they exercise a most important function for the further development of our acceptance business, and discount markets, their operation ought to be encouraged in every respect.

Gold coin and gold bullion as "goods."—Gold coin and gold bullion may properly be considered as goods.

Warehouse receipts of independent warehouses.—The Federal Reserve banks should make sure in purchasing or discounting bankers' acceptances or other bills which are secured by warehouse receipts, that the receipt is issued by a warehouse which is independent of the borrower.

Differential rate for member bank acceptances.—The differential rate between member bank acceptances and the acceptances of large non-member institutions, well known throughout the country, and, whose acceptances necessarily have a broad market, usually amount to one-quarter of one per cent. A higher differential rate than this figure is looked upon by the Board as inadvisable.

INELIGIBLE BANK ACCEPTANCES

OPINIONS OF COUNSEL AND RULINGS

Chattel mortgages ineligible.—Federal Reserve banks are directed to consider as ineligible bills drawn against the security of chattel mortgages on cattle and the like, whether accepted by member or non-member banks.

Bills payable outside the United States.—Any bill which is payable elsewhere than in the United States would not be eligible for purchase as a banker's acceptance even though eligible in all other respects. The acceptance, however, might properly be purchased as a bill of exchange payable in a foreign country.

EVIDENCE OF ELIGIBILITY OF BANK ACCEPTANCES

REGULATIONS OF THE FEDERAL RESERVE BOARD

Evidence to be furnished Federal Reserve Bank.—A Federal Reserve bank must be satisfied, either by reference to the acceptance iself or otherwise, that it is eligible for rediscount. Satisfactory evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal Reserve bank.

OPINIONS OF COUNSEL AND RULINGS

RELATING TO EVIDENCE OF ELIGIBILITY OF BANK ACCEPTANCES

Requirement of evidence.—The Federal Reserve bank reserves the right to ask State member banks for evidence underlying the certification given to it, and the bank examiner may require evidence from the

national banks to this effect. Member banks would, therefore, best protect themselves by stipulating for themselves the right at times to ask for substantiation of assurances given by their customers.

MATURITY RELATING TO BANK ACCEPTANCES

General Statutory Provisions

Period of maturity.—Any Federal Reserve bank may discount acceptances which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace.

REGULATIONS OF THE FEDERAL RESERVE BOARD

Relating to Maturity

Requirement as to maturity of bankers' acceptances discountable.—Federal Reserve banks may discount for their member banks "bankers' acceptances" which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace.

OPINIONS OF COUNSEL AND RULINGS

Relating to Maturity of Bank Acceptances

Renewals.—Acceptance business of Federal Reserve banks is not restricted to the original transaction only, if the transaction has not been liquidated. Member banks may renew the acceptance when the first acceptance matures, and there is no reason why a Federal Reserve bank may not discount such renewal acceptances, although a Federal Reserve bank must not engage in advance to make such discount of a renewal.

INDORSEMENT

General Statutory Provisions

Acceptances indorsed by member banks discountable.—Any Federal Reserve bank may discount acceptances which are indorsed by at least one member bank.

Blank indorsement.—An acceptance which is indorsed in blank can change ownership from one holder to another without being indorsed by each subsequent holder, and the title would pass. It might be interesting in this connection to note the expression by the Federal Reserve Board to the effect that it looks forward to the time when only bankers' acceptances bearing three responsible signatures, being those of the acceptor, the drawer, and the indorser, will be bought.

Readily marketable staples.—Any member bank may accept drafts which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering "readily marketable staples." Banks, as a matter of prudence and protection to themselves, should not consider as eligible any staple which is in its nature so perishable as not to be reasonably sure of maintaining its value as security at least for the life of the draft which is drawn against it. A more extended definition of a readily marketable staple would be "an article of commerce, agriculture or industry, of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of prices as to make (a) the price easily and definitely ascertainable, and (b) the staple itself easy to realize upon by sale at any time.

Acceptance of drafts drawn abroad and secured by foreign warehouse receipts.—A draft drawn abroad, payable in the United States in dollars and secured by a warehouse receipt covering readily marketable staples stored in a warehouse located in a foreign country, is eligible for acceptance by a member bank and after acceptance is eligible for rediscount by a Federal Reserve bank, but is not eligible for purchase by a Federal Reserve bank in the open market.

Acceptance of drafts secured by warehouse receipts.—No draft which is secured by a warehouse receipt should properly be considered eligible for acceptance unless the goods covered by the warehouse receipt are being held in storage pending a reasonable immediate sale, shipment, or distribution into the process of manufacture. Any draft therefore which is drawn to carry goods for speculative purposes or for an indefinite period of time without the purpose to sell, ship or manufacture within a reasonable time, should not be considered eligible for acceptance.

Qualified acceptance of sight draft.—A trade acceptance may be created by an acceptance of a sight draft in which the acceptor agrees to pay at a future date. Ordinarily this would constitute a qualified acceptance, and hence release the drawer and endorsers. If the drawer assents to the qualified acceptance, or does not dissent within a reasonable time, the instrument is considered to be a trade acceptance and therefore eligible for discount if otherwise in order.

Trade acceptance to finance structural work and other building operations in general.—A draft drawn by a manufacturer or materialman upon a builder to cover the cost of materials sold to the builder is eligible for rediscount as a trade acceptance when accepted by the builder. It is equally clear, however, that if the nature of the contract under which the building operations are being conducted is such that the contractor, for instance, does not get title either to the materials furnished or to the building as it is being erected, he cannot properly make a trade acceptance of a draft drawn upon him by the sub-contractor or builder, it being apparent that he has not been a purchaser of goods sold. If the drawer of the draft has sold goods to the drawee, the drawee may properly accept, and the draft thus accepted would constitute a trade acceptance if otherwise in conformity with the Board's regulations, but it should be noted that labor in itself is not considered goods within the meaning of these regulations. The Board has ruled, however, that a draft drawn to cover the purchase price of goods sold, plus the cost of installing those goods, may be eligible for acceptance as a trade acceptance.

SECTION VI

ACCEPTANCES AS AN INVESTMENT

Prime bank acceptances are especially desirable as an investment because they combine in a degree not found in any other commercial instrument the three important factors of safety, short maturity, and ready convertibility into cash.

SAFETY

When a bank accepts a draft it has created an obligation which it must, if it is to retain its standing, pay at maturity. The acceptance of a bank is as good as the bank itself, ranking with its cashier's check or certificate of deposit. But the drawer and indorsers of an acceptance are also liable, providing it is not paid at maturity and is properly protested. If one is satisfied that the funds he has deposited in his bank are safe, he can certainly find no objection from the standpoint of security to purchasing the acceptance of that same bank, or of another bank equally as good or better.

England, which heretofore has financed the foreign commerce of the world, has been enabled to do so largely because her bankers have purchased large amounts of acceptances and have loaned enormous sums at very low rates to dealers to enable them to carry bills. Their long experience has shown them that prime acceptances are the safest short-term investment they can find.

Our prime acceptances are just as good as those which have proved so satisfactory in England, and possibly better, because an eligible acceptance here is against a shipment of goods or is secured by goods; the only exception being bills for dollar exchange, in which case they are drawn by a bank and accepted by a bank.

MATURITY

Few acceptances appear in this market having a maturity longer than four months. The great majority are drawn payable ninety days after sight. Within these limitations the investor can usually secure

in the market bills approximating any maturity he may desire, whether it be for only three or four weeks or for the longer period. We have no other form of investment which can compete with acceptances in this respect.

The two features just mentioned make prime acceptances especially fitted as an investment for funds of corporations, firms or individuals, being accumulated for a special purpose, which will be paid out within a short time, such as funds for the payment of a dividend.

CONVERTIBILITY INTO CASH

Under the provisions of the Federal Reserve Act, the various Federal Reserve banks may purchase acceptances in the open market. The acceptances must, of course, be eligible; that is, must arise out of one of the four kinds of transactions mentioned heretofore.

As will be seen, the acceptance of any National bank is eligible. Non-member banks and bankers may make their acceptances eligible by filing with the Federal Reserve Bank a statement of financial condition, in form to be approved by the Federal Reserve Board. They must also agree in writing with the Federal Reserve Bank to inform it, upon request, concerning the transactions underlying their acceptances. Acceptances which the Reserve banks cannot purchase or rediscount are termed ineligible, and do not command as favorable a rate in the market as eligible bills.

The figures in any number of the Federal Reserve Bulletin will show the large volume of acceptances which have been purchased by the various Federal Reserve banks. This power to purchase and willingness on the part of the Federal Reserve banks to do so, as evidenced by the extent of their transactions, make a prime eligible acceptance in the hands of a member bank the most liquid investment that bank has. A member bank desiring to dispose of the acceptances of other banks which it holds, indorses those acceptances and sells them to its Federal Reserve bank at the prevailing rate for the purchase of acceptances. It should be noted that bank acceptances are sold to the Federal Reserve banks, not rediscounted. The purchase rates for prime indorsed bills are usually below the rediscount rates for paper. The nearer the acceptance approaches maturity the more favorable rate it commands at the Reserve banks.

The non-member bank, corporation or individual desiring to dispose of acceptances before maturity has always been able to do so to dealers in the open market, and ordinarily at very little difference from the rate at which the bills were purchased. In this connection it must be remembered that acceptances are discounted for the number of days they have to run from date of sale until maturity.

Bank acceptances are often drawn for odd amounts, representing the value of a shipment. They vary in size from a few hundred dollars to several hundred thousand dollars. It is, therefore, usually possible for an investor to purchase approximately any amount he may desire.

ACCEPTANCE OF DRAFTS BY STATE BANK MEMBERS

The Federal Reserve Board is without authority to permit a member bank to accept drafts drawn against it in domestic transactions in excess of 50 per cent. of the capital and surplus of the accepting bank. It may authorize a member bank to accept drafts up to 100 per cent., which amount may include both those which grow out of transactions involving the exportation or importation of goods and those which

ELIGIBILITY FOR REDISCOUNT OF MEMBER BANK ACCEPTANCES

Under the terms of section 13 any draft or bill of exchange which a member bank has the power to accept under the provisions of that section, is technically eligible for rediscount by a Federal Reserve Bank. This does not mean, however, that Federal Reserve Banks are required by law to rediscount every such acceptance tendered to them for that purpose. In developing a general market for acceptances the Federal Reserve Banks are necessarily called upon to carry a large amount of this class of paper, but it is important that the Federal Reserve Board and the Federal Reserve Banks should take all necessary steps to insure conservatism in the exercise of the acceptance power by member banks. The policy of the Board, therefore, as reflected in its various rulings, has been to caution Federal Reserve Banks that in rediscounting drafts accepted in domestic transactions they should consider, and in many cases investigate, the circumstances under which the draft was accepted in order to determine whether or not the particular transaction complies with the spirit was well as the letter of the statute.

PART IV

BANK AND TRADE ACCEPTANCES

COMMERCIAL BANKING

AND

CREDITS

FORMS, AGREEMENTS, RECORDS, ETC.

PART IV

Forms, Agreements, Records, Etc.

Form No. 1. Form of Trade Acceptance for General Use, Based on Domestic Sales of Merchandise.

" No. 2. Form of Trade Acceptance Based on Domestic Sales of Merchandise, with words "Maturity being in conformity with original terms of purchase," inserted.

" No. 3a. (Front) Form of Trade Acceptance with Explanation Slip for Buyer.

" No. 3b. (Reverse) Form of Trade Acceptance with Record Slip for Buyer.

" No. 4. Form of Trade Acceptance Adapted for General Use.

" No. 5. Form of Trade Acceptance Adapted for General Use.

" No. 6. Form of Trade Acceptance Adapted for General Use.

" No. 7. Form of Trade Acceptance Adapted for General Use.

" No. 8. Method of Propaganda Used by Commercial Houses to Encourage the Use of Trade Acceptances.

" No. 9. Method Employed by Commercial Houses to Point Out the Advantages in the Use of Trade Acceptances.

" No. 10. Acceptances in Foreign Countries (Canadian Practice).

" No. 11. Ordinary Banker's Acceptance; Specimen Bill Drawn Locally.

" No. 12. Bank Acceptance Arising Out of a Foreign Transaction; Specimen of Bill Drawn in a Foreign Country.

" No. 13. Forms of Certificates Used to Indicate Eligibility of Bankers' Acceptances for Re-discount with Federal Reserve Banks.

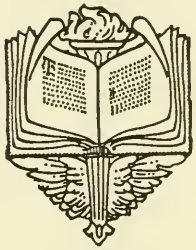
" No. 14. Specimen of Bank Acceptance Arising Out of a Transaction Involving the Exportation or Importation of Goods.

" No. 15. Bank Acceptance Arising Out of a Transaction Involving the Domestic Shipment of Goods.

" No. 16. Form of Bank Acceptance Based upon a Transaction Involving Warehouse Receipts.

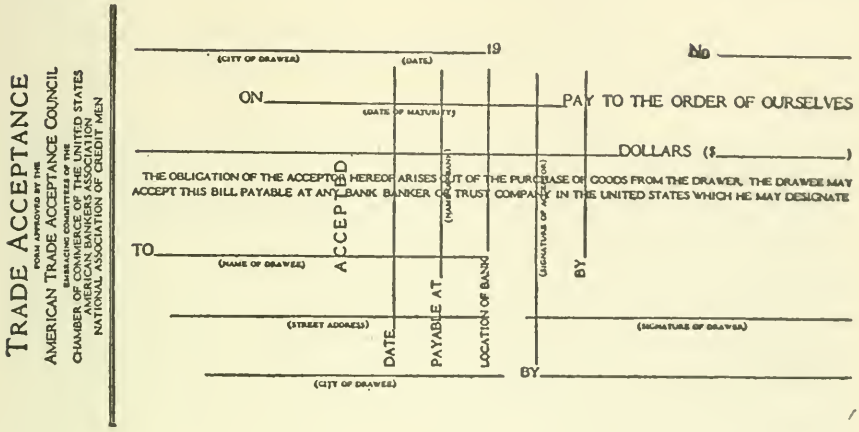
" No. 17. Commercial Domestic Acceptance Agreement.

" No. 18. Commercial Acceptance Agreement Used in Connection with Acceptance Credits Granted by a Bank for the Purpose of Financing Imports or Exports or Merchandise Stored in Warehouses in the United States or Abroad.
" No. 19. Trust Receipt Used in Connection with Acceptance Credits.
" No. 20. Trust Receipt Used in Connection with Acceptance Credits.
" No. 21. Trust Receipt (Documents for Warehousing).
" No. 22. Trust Receipt (For Withdrawal of Collaterals).
" No. 23. Bailee Receipt.
" No. 24. Form of Acceptance Register Book.



FORM NO. 1

Form of Trade Acceptance Based on Domestic Sale of Merchandise



EXPLANATION—FORM NO. 1

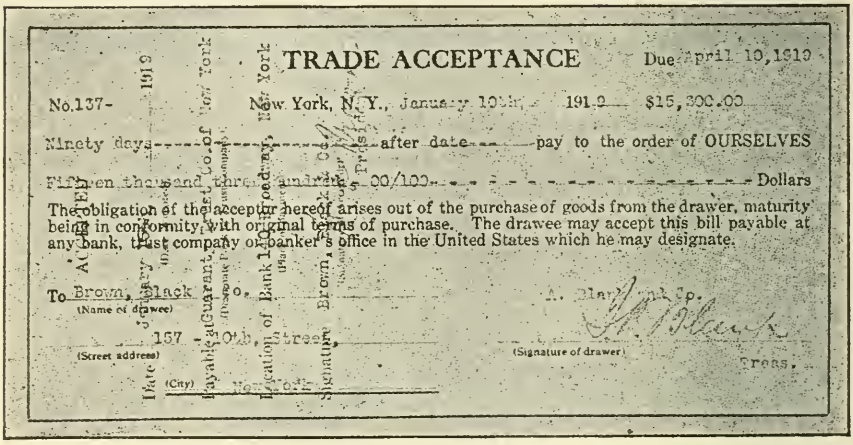
Form of Trade Acceptance Based on Domestic Sales of Merchandise

The acceptance is daily becoming more popular. It eliminates the old system of "open accounts." Instead of a merchant selling to a buyer on 60 days open account, the buyer accepts a draft at 60 days date or sight, which the merchant can discount with his bankers, thus avoiding a tie-up of his capital.

Some authorities have suggested that the words "maturity being in conformity with original terms of purchase" be inserted following the word "drawer" where it first appears in the form above, the purpose being to guard against the use of the trade acceptance in settlement of past due accounts. It should be remembered that trade acceptances are used in connection with current transactions only.

FORM NO. 2

Form of Trade Acceptance Based on Domestic Sale of Merchandise, with Words "Maturity Purchase" Inserted



TRADE ACCEPTANCE Due April 10, 1919

No. 137- New York, N. Y., January 10th, 1919 $15,300.00

Ninety days after date pay to the order of OURSELVES

Fifteen thousand three hundred 00/100 Dollars

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with original terms of purchase. The drawee may accept this bill payable at any bank, trust company or banker's office in the United States which he may designate.

To Brown, Black & Co.
(Name of drawee)

157 - 10th Street,
(Street address)

(City) New York

A. Blank and Co.
(Signature of drawer)

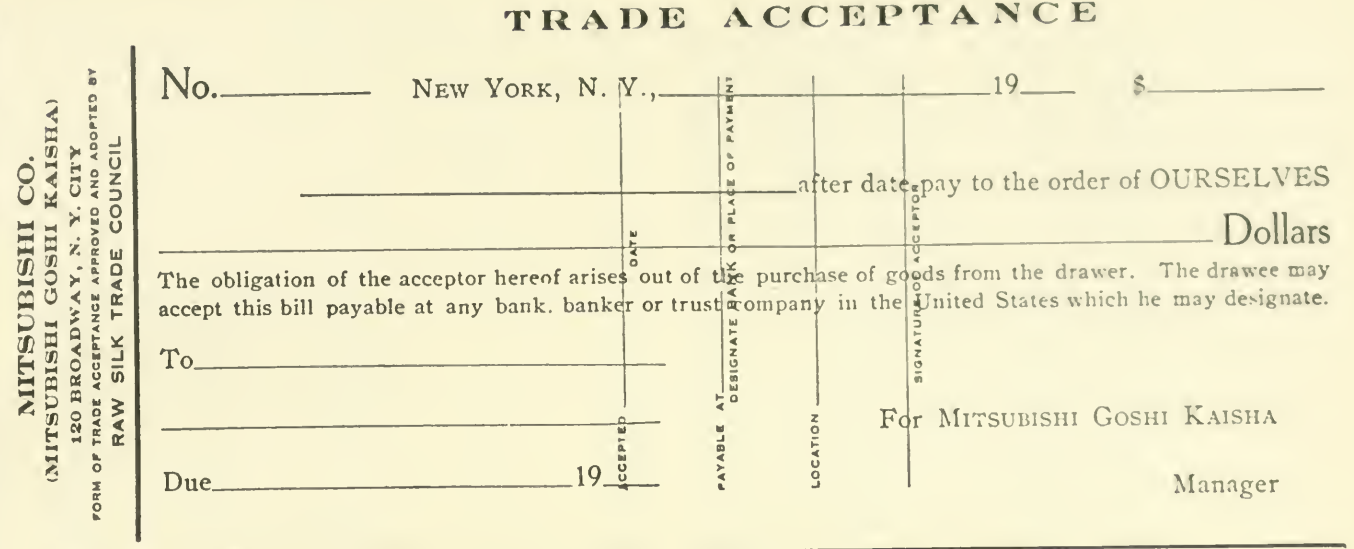
Treas.

EXPLANATION—FORM NO. 2

With the exception of the words "maturity being in conformity with original terms of purchase," this form of acceptance is the same as form No. 1. These words are inserted for the purpose of guarding against the use of the acceptance in settlement of past due accounts.

FORM NO. 3A FRONT

Form of Trade Acceptance (Front) with explanation slip for buyer


TRADE ACCEPTANCE
MITSUBISHI CO.
(MITSUBISHI GOSHI KAISHA)
120 BROADWAY, N. Y. CITY
FORM OF TRADE ACCEPTANCE APPROVED AND ADOPTED BY
RAW SILK TRADE COUNCIL
No.
NEW YORK, N. Y.,
19
$
after date pay to the order of OURSELVES
Dollars
The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawee may accept this bill payable at any bank. banker or trust company in the United States which he may designate.
To
Due
19
ACCEPTED
DATE
PAYABLE AT
DESIGNATE BANK OR PLACE OF PAYMENT
LOCATION
SIGNATURE OF ACCEPTOR
For MITSUBISHI GOSHI KAISHA
Manager

A TRADE ACCEPTANCE

Is an acknowledgment of a debt by the buyer in favor of the seller, for merchandise that the seller had placed in the hands of the buyer. The buyer agrees, in writing across the face of this acceptance his name, the name and location of his own bank and the date, to pay the amount of this certain indebtedness at a certain time at his own bank.

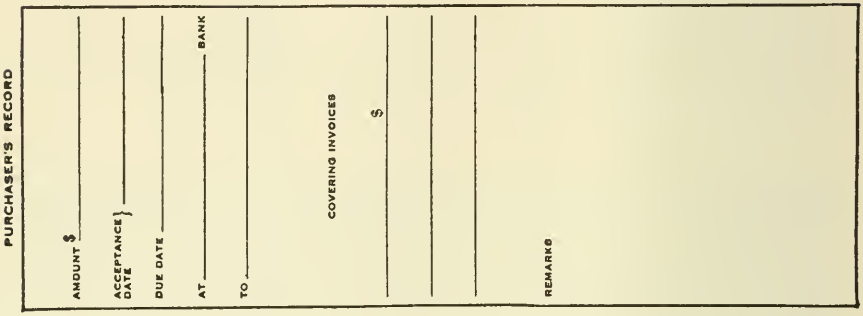
This varies from the open book account method only in giving the debt a negotiable value.

According to a FEDERAL RESERVE BANK GOVERNOR'S OPINION, the signing of an Acceptance increases the financial standing of the giver, because it shows prompt paying methods.

Kindly sign attached Acceptance, then forward to us.

FORM NO. 3B REVERSE

Form of Trade Acceptance (Reverse) with Record Slip for Buyer



EXPLANATION—FORM NO. 3A (FRONT); FORM NO. 3B (REVERSE)

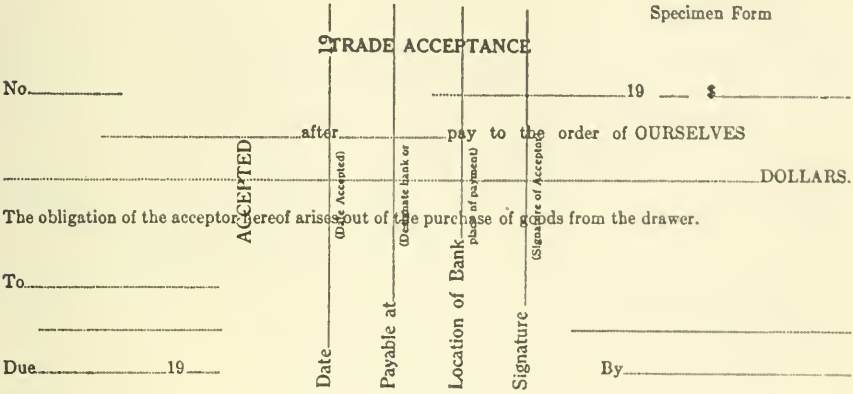
This form of trade acceptance serves the same purpose as those shown in forms Nos. 1 and 2 preceding, and in addition, furnishes an advantage in recording the particulars of the transaction. In usage, the seller fills in the particulars required in the trade acceptance and sends it along with the part following to the acceptor, the reverse side of which serves as a record sheet for the latter. After having been accepted, the trade acceptance is returned to the seller.

FORMS OF TRADE ACCEPTANCE

The following forms of trade acceptances are given for the convenience of commercial and financial houses, from which a choice may be made of a particular form which is best adapted to their use. The principles involved in the use of trade acceptances being the same, the only difference in the following is in the wording:

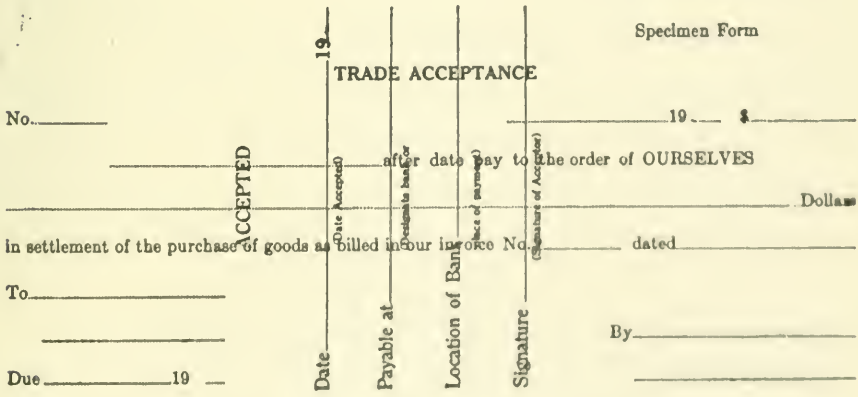
FORM NO. 4

Form of Trade Acceptance Adapted for General Use



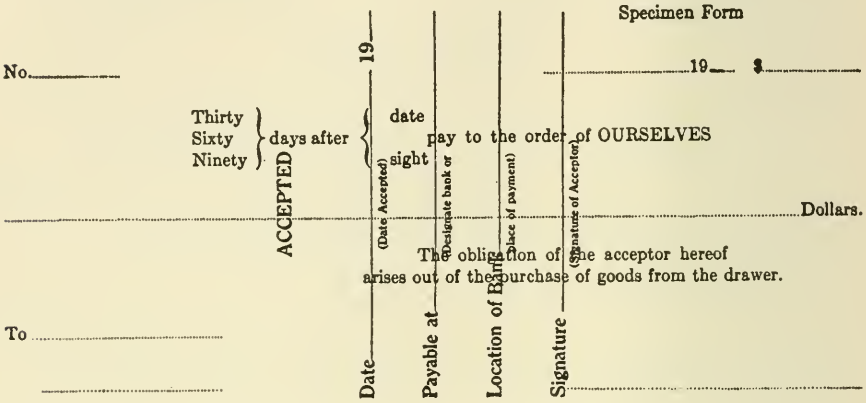
FORM NO. 5

Form of Trade Acceptance Adapted for General Use



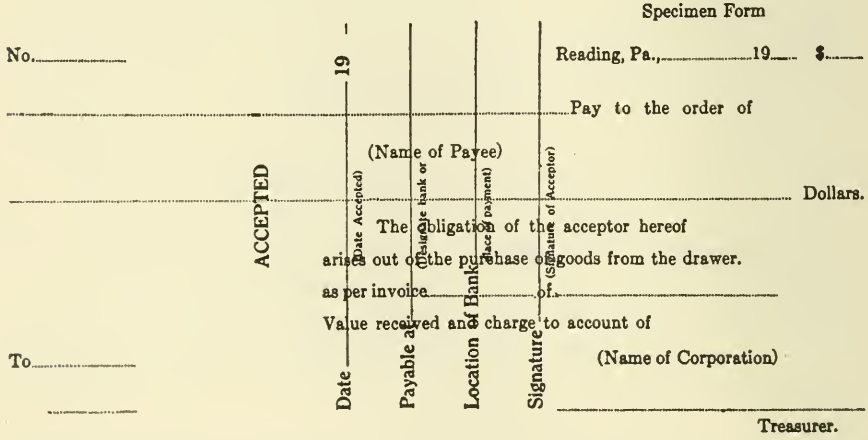
FORM NO. 6

Form of Trade Acceptance Adapted for General Use



FORM NO. 7

Form of Trade Acceptance Adapted for General Use



FORM NO. 8

Method of Propaganda used by Commercial Houses to encourage the use of Trade Acceptances

Before you decide how you will settle the accompanying account may we request you to consider the three methods by which purchases of "American Merchandise" products may be retired.

NO. 1	NO. 2	NO. 3
Discounting less 2% 10 days from date of shipment.	Completing and returning the Trade Acceptance or Negotiable Receipt attached.	Making payment net, 30 days from date of shipment.
RESULT	RESULT	RESULT
A saving to you of 2% in return for the investment of your capital in goods which you have yet to sell.	A saving of 1% in cost, and 60 days' time during which you may use the receipts coming in from the sale of the goods before you will be called upon to make any investment in them. The strengthening of your credit standing by advertising your promptness in meeting obligations.	Necessitates paying full price for goods which might be purchased for 99% of list price. Parting with full cost within 30 days when by co-operation and taking advantage of up-to-date methods 60 days' time might be legitimately taken.

It is evident that methods No. 1 and No. 2 lead to profitable results while method No. 3 is unprofitable to purchaser and seller alike. Purchasing on an open-account basis is rapidly becoming to be looked upon as unprofitable, inefficient and therefore obsolete. Give Trade Acceptances on Discount.

.....

TRADE ACCEPTANCE

Accepted ..... Present Date

Payable at ..... Designate Bank and City

..... Signature of Acceptor

$..... New York, N. Y., ...19....

..... days after date pay to the order of American Merchandise Distributing Co.

..... Dollars

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer.

In Settlement of our Invoice of ..... 19....

AMERICAN MERCHANDISE DISTRIBUTING CO.

To.....

..... By ..... President

EXPLANATION—FORM NO. 8

Form No. 8 illustrates a method of propaganda used by commercial houses to encourage the use of Acceptances. It points out clearly the usual forms of settling accounts and the advantages and disadvantages which accompany such modes of settlement.

FORM NO. 9

Method employed by commercial Houses to point out the advantages in use of trade acceptance

American Merchandise Distributing Co. Products are Cheaper

if purchased on acceptance terms instead of open account.

Had you accepted the draft sent you with original invoice of $ $_{100}$ this purchase would have cost you but $ $_{100}$ a saving of $ $_{100}$, and you would have had until .... 19...., to make settlement into the bargain.

In other words you can carry American Merchandise Distributing Co. products without investing a $ $ $ of your capital providing you can turn a jobber quantity of our goods in 60 days.

NEXT TIME WHY NOT SETTLE VIA THE TRADE ACCEPTANCE
IT WILL PAY YOU AND PROVE CONVENIENT.

EXPLANATION—FORM NO. 9

This form is sent to purchasers, with a receipt for cash settlement, pointing out the advantages in the use of the trade acceptance as a means of settling accounts. It is, as the preceding form, a good method of propaganda encouraging the use of trade acceptances.

FORM NO. 10

Acceptances in Foreign Countries (Canadian Practice)

ASSIGNMENT RE GOODS SUPPLIED.

TO THE UNION BANK OF CANADA

The annexed bill for $_____ dated _____ 19__

payable at _____ represents an indebtedness due to the undersigned by _____ the Drawee thereof, for goods actually supplied by the undersigned to Drawee, and the undersigned hereby assign and transfer to you the said indebtedness of the Drawee thereof and waive protest and notice of non-acceptance of the said bill; and authorize you at the expense and risk of the undersigned in event of non-acceptance to sue for and recover the amount of such indebtedness, with full power to compound or compromise the same, and the undersigned agrees to furnish you with a detailed statement of such indebtedness and with all evidence necessary to establish the same at the undersigned's expense; and if the amount, or any part thereof should be paid to us we will receive it as your Agents only, and will forthwith pay over the same to you.

Dated at _____

_____ 19____ _____

Form of Specific Assignment of Account. (Reduced size) Attached to trade paper drawn on firms who will not accept drafts.

Form

Reduced Size

Union Bank of Canada
TORONTO

Reasons for Returning Attached Bills are Crossed X.

Not due.
No funds.
Will remit.
No account.
Office closed.
Party will write.
Party has written.
Party in difficulties.
Not sufficient funds.
Goods not received.
Amount not correct.
Goods not as ordered.
No instructions to pay.
Cannot pay at present.
Will not pay exchange.
Wants extension of time.
Not in town at present.
Payment stopped by makers.
Notice given but no response.
Claims credit of goods returned.
Reasons endorsed on back of bill.
Payment refused—no reasons given.
Acceptance refused—no reasons given.
Acceptance refused—paid.

"Reasons for Refusal" slip—attached to bills returned unaccepted or unpaid.

½ Size

Hold reasonable time for arrival of goods. If unaccepted, ascertain definite reason and report

UNION BANK OF CANADA
TORONTO

"Hold for Arrival of Goods" slip usually attached to "sight" bills and to bills drawn contemporaneously with shipment of goods.

EXPLANATION—FORM NO. 10

Forms Nos. 10 a, b, and c, illustrate to what extent the acceptance idea prevails in other countries (Canadian practice).

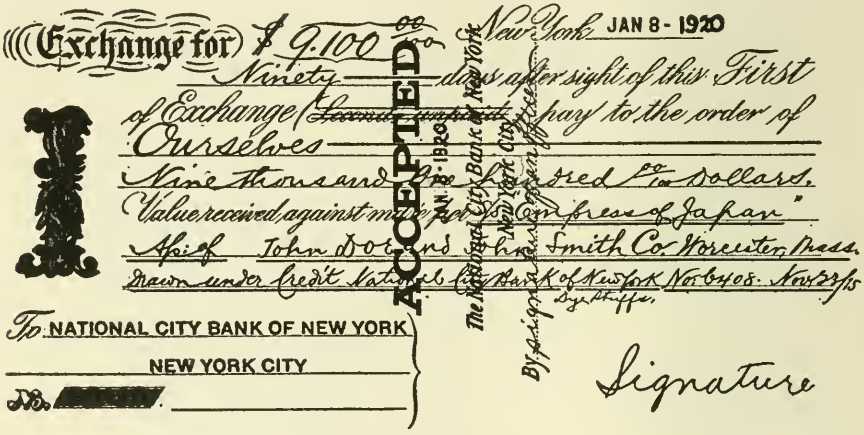
Form No. 10 a, above given, is used in assigning accounts to a bank, should a purchaser refuse to accept trade paper.

Form No. 10 b, accompanies the bill, and in the event of "refusal to sign" by the customer, the reason for such refusal is required to be indicated thereon.

Form No. 10 c, is at times necessary in view of the fact that goods might arrive subsequent to the time of presentation of the bill for acceptance. The necessity of this mode of procedure arises mostly in foreign trade transactions, where the "acceptor" is not inclined to obligate himself to pay at a future date with the possibility of the goods not arriving.

FORM NO. 11

Banker's Acceptance


Exchange for $ 9,100 00/100
New York JAN 8 - 1920
Ninety days after sight of this First
of Exchange pay to the order of
Ourselves
Nine Thousand One Hundred & 00/100 Dollars.
Value received against merchandise per "Canfreer of Japan"
Sp of John Doe and John Smith Co. Worcester, Mass.
Drawn under Credit National City Bank of New York No 61405 Nov 22/19
To NATIONAL CITY BANK OF NEW YORK
NEW YORK CITY
No.
ACCEPTED
1920
The National City Bank of New York
By signature of authorized officer
Signature

SPECIMEN BILL DRAWN LOCALLY

Specimen Bill Drawn Locally

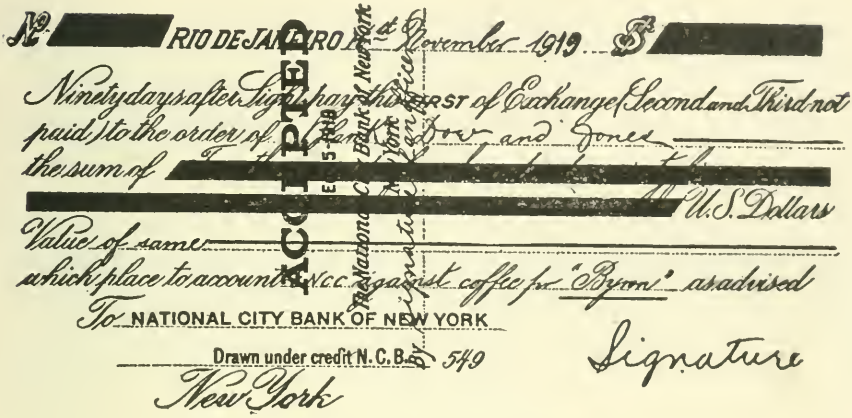
EXPLANATION—FORM NO. 11.

Form of Bank Acceptance—Specimen Bill Drawn Locally

As will be seen from an examination of the particulars contained in the acceptance, the purchaser, having arranged with his bank to have them accept drafts drawn upon them by the seller, the bank, in conformity with this acceptance agreement between itself and the purchaser, accepts such drafts drawn on it by the seller. After acceptance the draft becomes a "bank acceptance." The bank acceptance is a very high form of commercial paper and usually has a much better credit and commercial standing than the trade acceptance.

FORM NO. 12

Bank Acceptance Arising out of a Foreign Transaction


RIO DE JANEIRO
November 1919
Ninety days after Sight pay this FIRST of Exchange (Second and Third not paid) to the order of
the sum of
U.S. Dollars
Value of same
which place to account
To NATIONAL CITY BANK OF NEW YORK
Drawn under credit N.C.B.
549
New York
Signature

SPECIMEN BILL DRAWN IN FOREIGN COUNTRY

Specimen Bill Drawn in a Foreign Country

EXPLANATION—FORM NO. 12

Bank Acceptance—Specimen Bill Drawn in Foreign Country

This form differs from form No. 11 only in that the drawer is domiciled in a foreign country instead of in the United States. This form of bank acceptance arises also from an agreement between the bank and the purchaser, whereby the bank agrees to accept drafts drawn upon it up to a stipulated amount, by the shippers of goods abroad. Generally, the purchasers agree to supply the bank with funds with which to meet the draft at maturity.

FORM NO. 13

Forms of Certificates Used to Indicate Eligibility of Bankers' Acceptances for Rediscount with the Federal Reserve Banks

EXPORT OR IMPORT BILL

This acceptance is based upon a transaction involving the exportation or the importation of merchandise.

.....

Name of Acceptor.

DOMESTIC SHIPMENT BILL

At the time of acceptance, this bill was secured by shipping documents evidencing the domestic shipment of goods against which it was drawn.

.....

Name of Acceptor.

WAREHOUSE BILL

At the time of acceptance, this bill was secured by documents conveying or securing title, covering readily marketable staples stored in the United States.

.....

Name of Acceptor.

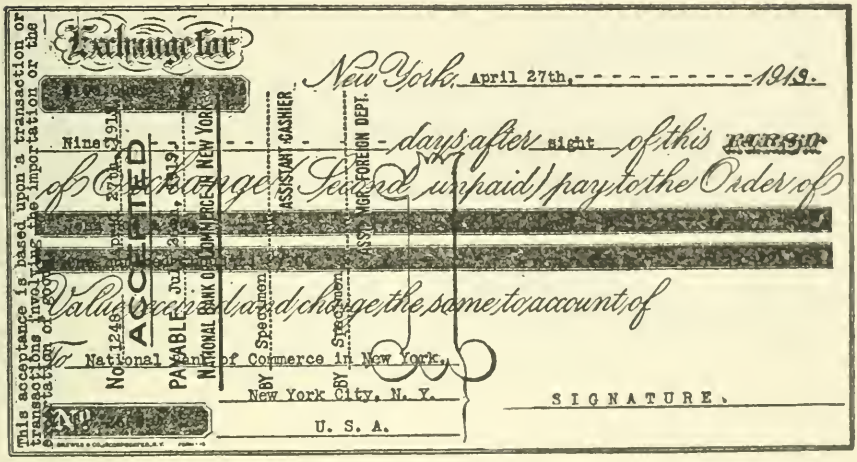
The above forms are employed and illustrated in the three following bank acceptances.

EXPLANATION—FORM NO. 13

Forms of certificates to be affixed by rubber stamps or in typewriting by a State bank, banker, or a trust company, for the purpose of showing that an acceptance is eligible for rediscount with the Federal Reserve Banks. These forms are employed and illustrated in the three bank acceptances following.

FORM NO. 14

Specimen of Bank Acceptance Arising out of a Transaction Involving the Exportation or Importation of Goods

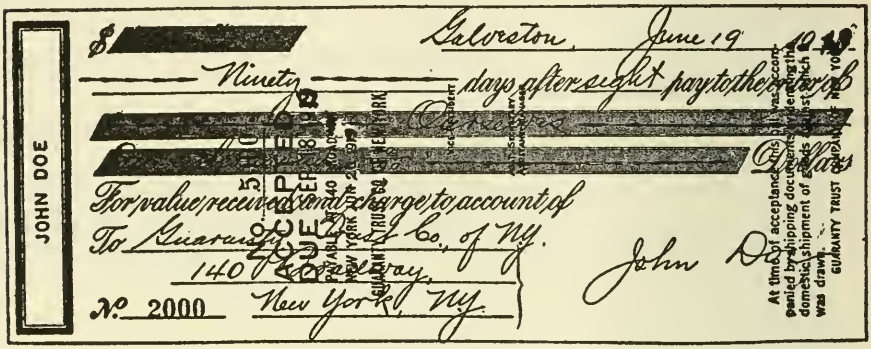

Exchange for
New York, April 27th, 1919.
days after sight of this
of Exchange Second unpaid, pay to the Order of
and charge the same to account of
To National Bank of Commerce in New York,
New York City, N. Y.
U. S. A.
SIGNATURE.
ACCEPTED
PAYABLE
NATIONAL BANK OF COMMERCE NEW YORK
ASSISTANT CASHIER
ASST. MGR. FOREIGN DEPT.
Specimen
This acceptance is based upon a transaction or transactions involving the importation or the exportation of goods

EXPLANATION—FORM NO. 14

The form of certificate to the left is one of the three given in No. 13, and is here shown as it would appear on a bank acceptance. Under the Federal Reserve Act, an acceptance to be eligible for rediscount, must arise out of a transaction involving the exportation or importation of goods, a domestic shipment bill, or a warehouse receipt. This draft falls within the first class of acceptances eligible for rediscount with the Federal Reserve Banks.

FORM NO. 15

Bank Acceptance Arising out of a Transaction Involving the Domestic Shipment of Goods

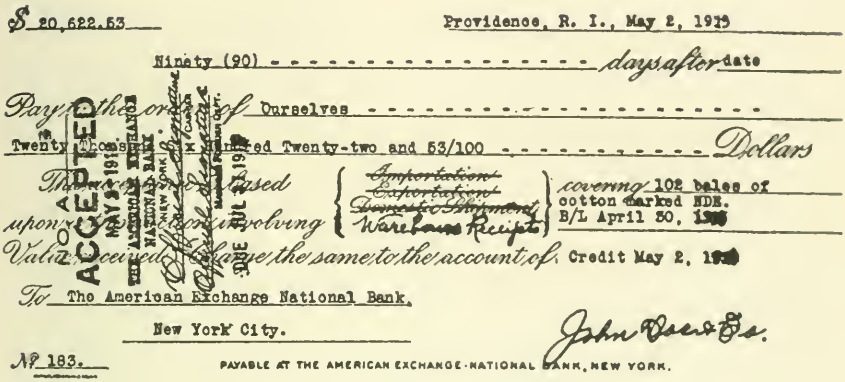

JOHN DOE
Galveston, June 19
Ninety days after sight pay to the order of
For value received and charge to account of
To Guaranty Trust Co. of N.Y.
140 Broadway,
No. 2000 New York, N.Y.
John Doe
At time of acceptance this draft was accompanied by shipping documents evidencing the domestic shipment of goods against which it was drawn.
GUARANTY TRUST COMPANY OF NEW YORK

EXPLANATION—NO. 15

This bank acceptance differs from No. 14 only in the form of certificate indicating its origin. In No. 14, the bank acceptance is based upon a transaction or transactions involving the importation or the exportation of goods. The acceptance illustrated to the left is one "evidencing the domestic shipment against which it was drawn." When this certificate is affixed by the bank, banker or trust company to the instrument, it becomes a bank acceptance eligible for rediscount with the Federal Reserve Banks. It is assumed that the transaction is bona fide and as stated and that the drafts conform in all other respects to the rules and regulations of the Federal Reserve Board.

FORM NO. 16

Form of Bank Acceptance Based upon a Transaction Involving Warehouse Receipts



$ 20,622.53 Providence, R. I., May 2, 1919

Ninety (90) - days after date

Pay to the order of Ourselves -

Twenty Thousand Six Hundred Twenty-two and 53/100 - - - - - - - - - - - - Dollars

Thereon Based upon a Transaction Involving { ~~Importation~~ ~~Exportation~~ ~~Domestic Shipment~~ Warehouse Receipts } covering 102 bales of cotton marked NDE. B/L April 30, 19[illegible]

Value received. Charge the same to the account of Credit May 2, 19[illegible]

To The American Exchange National Bank,

New York City.

John Doe & Co.

No 183.

PAYABLE AT THE AMERICAN EXCHANGE-NATIONAL BANK, NEW YORK.

ACCEPTED MAY 3 1919 THE AMERICAN EXCHANGE NATIONAL BANK NEW YORK

EXPLANATION—FORM NO. 16

To the left is a form of Bank acceptance based upon a transaction involving warehouse receipts. Note that the form here is different, though the purpose and idea are the same as in the bank acceptances illustrated in Nos. 14 and 15 preceding. As a time saver, this form is undoubtedly the better of the three, and can moreover be used for any of the three purposes described. An acceptance of this class is eligible for rediscount with the Federal Reserve Banks.

FORM NO. 17

COMMERCIAL DOMESTIC ACCEPTANCE AGREEMENT (a)

Giving Rise to Bankers' Acceptances

.....19....

For and in consideration of the acceptance by Trust Company/Bank of my/our draft on it numbered ..... dated ..... payable ..... for .... Dollars ($.....), and all other drafts which may hereafter be accepted by the..... Trust Company/Bank at my/our request, I/We hereby agree to place said Trust Company/Bank in possession of sufficient funds in cash previous to the maturity of said draft, and of any other drafts which said Trust Company/Bank may hereafter from time to time accept, to meet the maturity of said draft or drafts respectively, together with commission and interest as agreed.

I/We also assume all responsibility of, and said obligation to place said Trust Company/Bank in funds shall not be affected or impaired by, any risk or error in the course of transmission of telegrams and cablegrams or the loss of letters or other documents which may be sent in connection with the said drafts.

In the event of my/our suspension, failure or assignment for the benefit of creditors, or of a petition in bankruptcy being filed against me/us, or the non-fulfillment of any obligation hereunder on my/our part to be performed, all obligations and liabilities to said Trust Company/Bank on my/our part shall immediately, without notice, accrue and mature, and become due and payable, and it is also agreed that in any of those events, the said Trust Company/Bank may take such action with respect to the collection of any or all of said drafts as it may deem advisable to protect its interests and I/We hereby agree to indemnify and save said Trust Company/Bank harmless from any loss, costs, damage, expense (including reasonable attorneys' fees), suffered or incurred by reason of such action or by reason of my/our failure to perform any of the obligations arising hereunder.

This obligation shall continue in force and remain applicable notwithstanding any change in the individuals comprising our firm, whether such change shall arise from the ascession of one or more new partners or from the death, retirement or succession of any partner or partners.

All rights arising under this agreement shall be determined according to the laws of the State of

..... (L. S.).

EXPLANATION—FORM NO. 17

Herewith is Given a Form of Acceptance Agreement

Here, a purchaser, through arrangement with his bank, may have the seller draw his draft on the latter and accepted by such bank, instead of by himself. As the transaction is one to be carried out entirely within the United States, it is called a Commercial Domestic Acceptance Credit.

This is the usual acceptance agreement between the customer and the bank, whereby the bank undertakes to accept drafts which may be drawn upon it by the seller, on behalf of the buyer, the latter undertaking to supply the bank (acceptor) with funds with which to meet the drafts as they fall due.

FORM NO. 18

ACCEPTANCE AGREEMENT

Used in Connection with Acceptance Credits Granted by a Bank for the Purpose of Financing Imports or Exports to or from the United States, or Merchandise Stored in Warehouses in the United States or Abroad while awaiting shipments to this or another country

(Front)

For and in consideration of the acceptance by GUARANTY TRUST COMPANY OF NEW YORK, of my/our draft on it numbered ..... dated ..... payable ..... for ..... Dollars ($.....), and all other drafts which may hereafter be accepted by the Guaranty Trust Company of New York at my/our request, I/we hereby deposit and assign and transfer to said Trust Company as collateral security for the payment of said drafts at maturity, as well as for the payment of any and every debt or liability of every nature from the undersigned to said Trust Company.

.....

.....

.....

.....

with such additional collaterals as may from time to time be required by any of the officers of said Trust Company, and which the undersigned hereby promises to furnish on demand. And the undersigned hereby gives to said Trust Company, or its assigns, full power to sell, assign and deliver the whole or any part of said collaterals, or any substitutes therefor, or any additions thereto, at any Brokers' Exchange or elsewhere at public or private sale, at the option of such holder, on the non-performance of any of the promises herein contained, and without notice of amount due or claimed to be due, without demand of payment, without advertisement and without notice of the time or place of sale, each and every of which is hereby expressly waived; and on any such sale the Trust Company, its assigns or any of the officers of said Trust Company, may purchase on its own account and without further accountability except for the purchase price thereof the whole or any part of the property sold free from any right of redemption on the part of the undersigned, which right is hereby waived and released.

It is further agreed, that any surplus arising from the sale of said collaterals, beyond the amount due hereon, shall be applicable upon any claim of the said Trust Company arising directly or by assign-

ment against the undersigned at the time of said sale, whether the same be then due or not due.

And it is further agreed that any moneys or properties, at any time, in the possession of GUARATY TRUST COMPANY OF NEW YORK belonging to any of the parties liable hereon to said Trust Company, and any deposits, balance of deposits or other sum at any time credited by or due from said Trust Company to any of said parties, shall at all times be held and treated as collateral security for the payment of any other obligation, indebtedness or liability of the undersigned to the said Trust Company, whether due or not due, and said Trust Company may at any time, at its option, set off the amount due or to become due hereon or any other obligations against any claim of any of said parties against said Trust Company.

And I/we also agree to place said Trust Company in possession of sufficient funds in cash previous to the maturity of said draft, and of any other drafts which the said Trust Company may hereafter from time to time accept to meet the maturity of said draft or drafts respectively, together with commission as agreed and any interest which may accrue thereon, calculated at the rate of six per cent (6%) per annum. Any and all drafts or bills of exchange now or hereafter delivered by me/us to said Trust Company to be collected shall be delivered to and received by it as security for said acceptance or acceptances without impairing in any way my/our obligation hereunder to place said Trust Company in funds before the maturity of said acceptance or acceptances as aforesaid, and all documents relating to such bills for collection shall likewise be held and received by said Trust Company as security with the privilege of delivering same to drawees upon acceptance or acceptances unless instructions to the contrary shall be attached to each bill.

The said Trust Company shall have the right to apply the proceeds of such collections against the payment of said acceptance or acceptances and of any other indebtedness due or to become due from me/us.

It is expressly agreed that I/we assume all responsibility for the collection of drafts or bills delivered as aforesaid and for any loss, costs or expenses suffered or incurred by said Trust Company in connection therewith, and that said Trust Company shall be held free of responsibility for, and my/our obligation to place said Trust Company in funds as aforesaid shall not be affected or impaired by, any default, neglect, suspension, insolvency or bankruptcy of any correspondent or sub-agent, to whom said bills or drafts may be entrusted for collection or for any delay in remittance, loss in exchange, or the loss of the said drafts or bills or their proceeds during transmission or in the course of their collection, and I/we expressly agree to assume all responsibility for, and that my/our said obligation to said Trust Company shall not be affected or impaired by, the non-payment of any bills of exchange which may be received by said Trust Company or by any collecting bank, agent or sub-agent in payment of such drafts or bills of exchange.

I/we also assume all responsibility of, and said obligation to place said Trust Company in funds shall not be affected or impaired by, any risk or error in the course of transmission of telegrams and cablegrams or the loss of letters or other documents which may be sent in connection with the said drafts or bills for collection.

I/we also agree that in the event that any of the said Trust Company's correspondents, agents or sub-agents for collection of said drafts or bills shall advise it that any of said drafts or bills are not promptly accepted or paid, or in the event of the suspension, failure or assignment for the benefit of creditors, or by the filing of a petition in bankruptcy against the drawee or the drawees of any of said bills for collection, that I/we will immediately upon receipt of such notice, waiving protest, and notice of protest, pay or cause to be paid to said Trust Company in cash the face amount of any such draft or bill for collection which has not been accepted or the drawee of which has suspended, failed or assigned or against whom a petition in bankrutpcy has been filed as aforesaid.

In the event of my/our suspension, failure or assignment for the benefit of creditors, or of a petition in bankruptcy being filed against me/us, or the non-fulfillment of any obligation hereunder on my/our part to be performed, all obligations and liabilities to said Trust Company on my/our part shall immediately, without notice, accrue and mature and become due and payable, and it is also agreed that in either of those events, said Trust Company may take such action with respect to the collection of any or all of said drafts and bills delivered as aforesaid for collection as it may deem advisable to protect its interests, and I/we hereby agree to indemnify and save said Trust Company harmless from any loss, costs, damage, expense (including reasonable attorneys' fees), suffered or incurred by it by reason of such action or by reason of my/our failure to perform any of the obligations arising hereunder.

This obligation shall continue in force and remain applicable notwithstanding any change in the individuals comprising our firm, whether such change shall arise from the accession of one or more new partners or from the death, retirement or succession of any partner or partners.

All rights arising under this agreement shall be determined according to the laws of the State of New York.

..... 19....

(Reverse side)

WHEREAS, ...
the undersigned has/have requested the Guaranty Trust Company of New York to accept the drafts mentioned and described in the acceptance agreement of ..... dated the ..... of ..... 19...., printed on the reverse side hereof, and

WHEREAS, the said Guaranty Trust Company of New York is

willing to execute such acceptances provided the undersigned will unconditionally guarantee to it the prompt payment at maturity of the said drafts and of any other drafts of ..... which the said Trust Company may hereafter accept from time to time.

NOW, IN CONSIDERATION OF THE PREMISES and of the sum of One Dollar to the undersigned in hand paid, the receipt whereof is herby acknowledged, the undersigned do ..... hereby unconditionally guarantee to the said GUARANTY TRUST COMPANY OF NEW YORK, its successors, endorsees and assigns, the prompt payment at maturity of any and all drafts accepted by the GUARANTY TRUST COMPANY OF NEW YORK, pursuant to said acceptance agreement, and any and all renewals and extensions thereof, the prompt performance by ..... of all the terms, conditions and covenants contained in said acceptance agreement, and the payment of every debt and liability of .... to the Guaranty Trust Company of New York.

The undersigned hereby consents to any renewal and extension of time of payment of any draft, drafts or other indebtedness that may be granted by the Guaranty Trust Company of New York, and do .... also consent that the securities set forth in said acceptance agreement may be exchanged or surrendered from time to time without notice to, or further assent from the undersigned, and that the undersigned will remain bound upon this guarantee notwithstanding such changes, surrenders, renewals and extensions.

The undersigned expressly waives presentment, demand of payment, protest and notice of dishonor of said drafts and acceptances thereof, and does also waive notice of the nonperformance on the part of ..... of any of the provisions or covenants of the aforesaid acceptance agreement on his/its/their part to be performed and notice of any sale of the collateral securties aforesaid.

This guarantee is made without any limitation as to duration or amount, and the undersigned agree ..... that it shall continue and that the said Guaranty Trust Company of New York may continue to act on the faith thereof to any extent until such time as the said Trust Company shall receive from me/us written notice of its withdrawal; which notice, however, shall not in any wise affect any draft and acceptance theretofore made or any other liability theretofore incurred, whether then due and payable or thereafter to become due and payable, and not fully paid at the time of the receipt by the said Trust Company of said notice.

The undersigned declares to and covenants with the said Guaranty Trust Company of New York, its successors, endorsees and assigns, that the undersigned ha— no defense whatsoever to any action, suit or proceeding at law, or otherwise, that may be instituted upon this guarantee.

This guarantee shall be construed in accordance with the laws of the State of New York.

IN WITNESS WHEREOF, the undersigned ha— set his/our hand and seal this ..... day of ..... 19....

..... (L. S.).

EXPLANATION—FORM NO. 18

Acceptance Agreement

Copy of an "acceptance agreement" which is used in connection with acceptance credits granted by a bank for the purpose of financing imports or exports to or from the United States, or merchandise stored in warehouses in this country, or in warehouses in other countries, while awaiting shipment to the United States, or another country.

This form of agreement is signed by the client of the bank at the time the credit is arranged for.

There is no material difference between the operation of an acceptance which arises out of a foreign transaction and one between commercial firms in this country, except that in the latter, the mode of payment would be in "dollars" whereas in the former, it may be made available to the drawer in the currency of his locality. Such drafts being accepted by the bank, become "bank acceptances" drawn in a foreign country. (Form No. 12).

FORM NO. 19

Trust Receipt Used in Connection With Acceptance Credits

Received from the ..... TRUST COMPANY/BANK, hereinafter called the TRUST COMPANY/BANK, the following goods and merchandise, their property specified in warehouse receipt/bill of lading.

..... warehouse, dated .....

..... consignor, consignee .....

goods described as follows:

In consideration thereof we hereby agree to hold said goods and merchandise in trust for said TRUST COMPANY/BANK and as its

property and subject to its order, and it is understood and agreed that the warehouse receipt/bill of lading and the goods and merchandise represented thereby and any other document of title which may be issued in respect thereof is held by us only as trustees for the benefit of the TRUST COMPANY/BANK, without giving us any title to the goods and merchandise they represent, except as trustees for the benefit of said TRUST COMPANY/BANK. It is agreed that we are to have power subject to the same conditions, to sell or manufacture, or cause to be manufactured, products from such goods and merchandise, and to sell such manufactured products for the account of and as trustees for said TRUST COMPANY/BANK.

We further agree to keep said property or manufactured products thereof insured against fire, payable in case of loss to the said TRUST COMPANY/BANK as interest may appear, with the understanding that it is not to be chargeable for any expense incurred thereby, the intention of the arrangement being to protect and preserve the title of the TRUST COMPANY/BANK to the goods or proceeds thereof without expense.

Signed .....

EXPLANATION—FORM NO. 19

Trust Receipt

Form to be signed and returned to bank by purchaser or party in whose behalf bank has accepted. The purpose of the "trust receipt" in "bank acceptances" is to give to the purchaser, upon his signing the "trust receipt" possession or right to possession of the goods covered by it, governed by limitations as to mode of payment, guaranty, security, etc., to be given by the "purchaser" to the bank. Trust receipts are sometimes accepted as temporary collateral from responsible parties in exchange for shipping documents or warehouse receipts. They are also used in connection with Import and Export Letters of Credit and loans.

FORM NO. 20

Trust Receipt Used in Connection With Acceptance Credits

Received from River National Bank of St. Louis the following goods and merchandise, their property, specified in the Bill of Lading per ..... R. R., Dated ..... marked and numbered as follows:

and, in consideration thereof, WE HERBY AGREE TO HOLD SAID GOODS IN TRUST for them, and as their property, with liberty to sell the same for their account, and further agree, in case of sale, to hand the proceeds to them to apply against the acceptances of River National Bank of St. Louis on our account, under the terms of the Letter Credit No. ..... for our account and for the payment of any other indebtedness of ours to River National Bank of St. Louis.

The River National Bank of St. Louis, may at any time cancel this trust and take possession of said goods, or of the proceeds of such of the same as may then have been sold, wherever the said goods or proceeds may then be found and in the event of any suspension, or failure, or assignment for the benefit of creditors, on our part, or of the non-fulfillment of any obligation, or of the non-payment at maturity of any acceptance made by us under said credit, or under any other credit issued by River National Bank of St. Louis, on our account or of any indebtedness on our part to them, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon (with or without notice) mature and become due and payable. The said goods while in our hands shall be fully insured against loss by fire.

Dated, New York City ..... 19....

(Signed) .....

$.....

EXPLANATION—FORM NO. 20

Trust Receipt

This form of trust receipt is used for the same purposes as that in No. 19. The only difference between the two is in the wording.

FORM NO. 21

Trust Receipt

(DOCUMENTS FOR WAREHOUSING)

RECEIVED from The Guaranty Trust Co. of New York Bill of Lading per ..... dated ..... for the following goods and merchandise, their property, marked and numbered as follows:

imported under the terms of Letter of Credit No. ....., issued by them for my/our account the said Bill of Lading to be used by me/us for the sole purpose of entering the above described property at the United States Custom House at the Port of .... and of storing the same in the name, and as the property, of the said The Guaranty Trust Co. of New York, and subject only to their order, I/we hereby agreeing to so store the said property and to hand the storage receipt for the same to the said The Guaranty Trust Co. of New York, when obtained.

I/we ALSO AGREE to fully insure said property against fire, the loss, if any, payable to said The Guaranty Trust Co. of New York, and to hand to them the policies of insurance thereon.

Dated ..... 19....

(Signed) .....

£.....

EXPLANATION—FORM NO. 21

Trust Receipt

(DOCUMENTS FOR WAREHOUSING)

This form of Trust Receipt is also used in connection with Import Letters of Credit, and it is temporarily accepted against the surrender of shipping documents in order that the goods covered by such documents may be placed in warehouse, and pending the delivery of the warehouse receipt.

This form of Trust Receipt is used covering the delivery of merchandise actually sold, the relative shipping documents being surrendered to the client against his trust receipt in order to enable him to make delivery to the buyer.

FORM NO. 22

Trust Receipt for Withdrawal of Collaterals

Trust Receipt for Withdrawal of Collaterals

Loan of ..... New York, ...
Received from Guaranty Trust Co. of New York, the following property held by the Guaranty Trust Co. of New York, as collateral security:

.....
.....
.....
.....
.....

and in consideration thereof we/I hereby agree, acting as agents for the Guaranty Trust Co. of New York, in this matter, to hold said property in trust, for the following purposes only, viz:

.....
.....
.....

with the understanding that we/ I will hand the .....
.....

as soon as received to the Guaranty Trust Co. of New York, the intention of this agreement being to protect and preserve unimpaired the lien of the Guaranty Trust Co. of New York, on said property.

.....
.....

EXPLANATION—FORM NO. 22

The "Trust Receipt for Withdrawal of Collaterals" illustrated at the left, upon its being signed and returned to the bank, passes possession or right to possession of the goods, to the signatory, the latter at the same time recognizing the lien of the bank on said property.

FORM NO. 23

Bailee Receipt

RECEIVED from the GUARANTY TRUST COMPANY OF NEW YORK solely for the purpose of selling same for account of said Company:

.....

.....

marked and numbered .....

and ..... hereby undertake to sell the property herein specified, for account of the said Company, and collect the proceeds of the sale or sales thereof, and deliver the same immediately on receipt thereof to the said Company, to be applied to the credit of .....

.....

hereby acknowledging ..... to be Bailee of the said property for the said Company, and ..... do hereby assign and transfer to the said Company the accounts of the purchaser or purchasers of said property to the extent of the purchase price thereof, of which fact notice shall be given at the time of delivery of the said property by ..... to such purchaser or purchasers and all invoices therefor shall have imprinted, written or stamped thereon by ..... the following:

"Transferred and payable to GUARANTY TRUST COMPANY OF NEW YORK, 140 Broadway, New York."

If the said property is not sold and the proceeds so deposited within ten days from this date, ... undertake to return all documents at once on demand, or to pay the value of the goods, at the Company's option.

The said goods while in my/our hands shall be fully insured against loss by fire.

The terms of this receipt and agreement shall continue and apply to the merchandise above referred to whether or not control of the same, or any part thereof, be at any time restored to the Guaranty Trust Company of New York, and subsequently delivered to us.

Dated at New York City, ... 19....

.....

EXPLANATION—FORM NO. 23

Bailee Receipt

This form of receipt is very specific as to the terms and conditions under which possession of merchandise is obtained.

Trade Acceptance Register

Sheet No. _____

Memorandum Record
for Drawer or Acceptor

_____ 19____

	No.	Trade Acceptance Received From	Date of Invoice	Amount of T. A.	Posted	Where Payable	Date Dis. or Collec.	Bank
		Amount Brought Forward						

EXPLANATION—FORM NO. 24

Form of Record Book for Acceptances, Drafts, Bills, Notes, etc.

The Trade Acceptance accompanies the invoice and is sent to the purchaser, who accepts same. At the time it is sent to such purchaser a record is taken of the sale by a proper entry in the sales book, as in the "open account method." The acceptance when returned to the seller is then entered in the "acceptance register" from where it may be posted to the ledger to offset the outstanding indebtedness of the customer. Some firms treat the acceptance as an entire cancellation of the debt; others merely as a matter of record.

PART V

BANK AND TRADE ACCEPTANCES

COMMERCIAL BANKING AND CREDITS

LAWS

The Negotiable Instruments Law, Digest of the Federal Bill of Lading Law, The United States Warehouse Act, Laws Relating to the Taxation of Negotiable Instruments, Checks, Drafts, Bank and Trade Acceptances, and Promissory Notes

THE

NEGOTIABLE INSTRUMENTS

LAW

The purpose of which is to make uniform throughout the United States the law relating to negotiable commercial paper.

PRELUDE TO THE NEGOTIABLE INSTRUMENTS LAW

The Negotiable Instruments Law was codified and approved by several States in the Union in the year 1897, and was adopted in whole or in part, within the few following years by a majority of the States. In the few jurisdictions of the United States where the Negotiable Instruments Law has not been passed, the law relating to bills, notes and checks is based on the principles of the common law, which is a series of rules and precedents originating in the Courts of England and the United States, and which were decided during the past few centuries on questions as they arose from time to time.

The Negotiable Instruments Law in such States in which it was passed, does not abolish the entire system of common law governing bills, notes and checks, but only restates the rules of the common law which existed prior to the enactment of the Statute. The common law, where it conflicts with the Statute Law, gives precedence to the latter, though the common law still remains important due to the fact that cases frequently arise which are not clearly covered by the Statutes.

This particular point is clearly outlined in Section 196 of the Law of Negotiable Instruments which provides that in cases not provided for by the Statute, the unwritten law prevails.

Below is given a list of the States and territories which have adopted the Negotiable Instruments Law in whole or in great part.

For any variation, reference must be made to the Statute of that particular State.

LIST OF STATES AND TERRITORIES IN WHICH THE NEGOTIABLE INSTRUMENTS LAW HAS BEEN ADOPTED

Alabama. Laws of 1907, No. 722, p. 660. In effect January 1, 1908.
Arizona. Rev. St. 1901, p. 852; Laws 1905, Ch. 23. In effect September 1, 1901.
Arkansas. Laws of 1913, Act 81. In effect April 22, 1913.
Colorado. Laws of 1897, Ch. 64. Approved April 20, 1897.

Connecticut. Laws of 1897, Ch. 74. Approved April 5, 1897.
Delaware. Laws of 1911, Ch. 191. In effect January 1, 1912.
District of Columbia. Laws of 1899, Chap. 47; 30 U. S. Stat. at L., p. 785. In effect April 3, 1899.
Florida. Laws of 1897, Chap. 4524. Approved June 1, 1897.
Hawaii. Laws of 1907, Act 89. In effect April 20, 1907.
Idaho. Laws of 1903, p. 380. In effect March 10, 1903.
Illinois. Laws of 1907, p. 403. Approved June 5, 1907.
Indiana. Laws of 1913, Chap. 63. Approved March 3, 1913.
Iowa. Laws of 1902, Chap. 130; Laws of 1906, Chap. 149. Approved April 12, 1902.
Kansas. Laws of 1905, Chap. 310. In effect June 8, 1905.
Kentucky. Laws of 1904, Chap. 102. Approved March 24, 1904.
Louisiana. Laws of 1904, Act 64. Approved June 29, 1904.
Maryland. Laws of 1898, Chap. 119. Approved March 29, 1898.
Massachusetts. Laws of 1898, Chap. 533; Laws of 1899, Chap. 130. In effect January 1, 1899.
Michigan. Laws of 1905, Chap. 265, p. 389. Approved June 16, 1905.
Minnesota. Laws of 1913, Chap. 272. In effect July 1, 1913.
Missouri. Laws of 1905, p. 243. Approved April 10, 1905.
Montana. Laws of 1903, Chap. 121. In effect March 7, 1903.
Nebraska. Laws of 1905, Chap. 83. In effect August 1, 1905.
Nevada. Laws of 1907, Chap. 62. In effect May 1, 1907.
New Hampshire. Laws of 1909, Chap. 123. In effect January 1, 1910.
New Jersey. Laws of 1902, Chap. 184. Approved April 4, 1902.
New Mexico. Laws of 1907, Chap. 83. Approved March 21, 1907.
New York. Laws of 1897, Chap. 612; Laws of 1898, Chap. 336. In effect October 1, 1897.
North Carolina. Laws of 1899, Chap. 733; Laws of 1905, Chap. 327; Laws of 1907, Chap. 897. In effect March 8, 1899.
North Dakota. Laws of 1899, Chap. 113. Approved March 7, 1899.
Ohio. Laws of 1902, p. 162. In effect January 1, 1903.
Oklahoma. Laws of 1909, Chap. 24. In effect June 10, 1909.
Oregon. Laws of 1899, p. 18. Approved February 16, 1899.
Pennsylvania. Laws of 1901, p. 194. In effect September 2, 1901.
Rhode Island. Laws of 1899, Chap. 674. In effect July 1, 1899.
South Carolina. Laws of 1914, Act No. 396, p. 668. Vetoed by the governor March 4, 1914, and passed by both Houses over his veto.
South Dakota. Laws of 1913, Chap. 279. Approved March 4, 1913.

Tennessee. Laws of 1899, Chap. 94. In effect May 16, 1899.
Utah. Laws of 1899, Chap. 83. In effect July 1, 1899.
Vermont. Laws of 1912, p. 114. In effect June 1, 1913.
Virginia. Laws of 1898, Chap. 866. Approved March 3, 1898.
Washington. Laws of 1899, Chap. 149. In effect March 22, 1899.
West Virginia. Laws of 1907, Chap. 81. In effect January 1, 1908.
Wisconsin. Laws of 1899, Chap. 356. In effect May 15, 1899.
Wyoming. Laws of 1905, Chap. 43. In effect February 15, 1905.

THE NEGOTIABLE INSTRUMENTS LAW

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THE NEGOTIABLE INSTRUMENTS LAW

ARTICLE I.

GENERAL PROVISIONS.

§1. Short title.
§2. Definitions and meaning of terms.
§3. Person primarily liable on instrument.
§4. Reasonable time, what constitutes.

§5. Time, how computed; when last day falls on holiday.
§6. Application of chapter.
§7. Rule of law merchant; when governs.

§1. Short title.—This act shall be known as the Negotiable Instruments Law.

§2. Definitions and meaning of terms.—In this act, unless the context otherwise requires:

"Acceptance" means an acceptance completed by delivery or notification.

"Action" includes counter-claim and set-off.

"Bank" includes any person, or association of persons carrying on the business of banking, whether incorporated or not.

"Bearer" means the person in possession of a bill or note which is payable to bearer.

"Bill" means bill of exchange, and "note" means negotiable promissory note.

"Delivery" means transfer of possession, actual or constructive, from one person to another.

"Holder" means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof.

"Indorsement" means an indorsement completed by delivery.

"Instrument" means negotiable instrument.

"Issue" means the first delivery of the instrument, complete in form, to a person who takes it as a holder.

"Person" includes a body of persons, whether incorporated or not.

"Value" means valuable consideration.

"Written" includes printed, and "writing" includes print.

§3. Person primarily liable on instrument.—The person "primarily" liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are "secondarily" liable.

§4. Reasonable time, what constitutes.—In determining what is a "reasonable time" or an "unreasonable time," regard is to be had to the nature of the instrument, the usage of trade, or business (if any) with respect to such instruments, and the facts of the particular case.

§5. Time, how computed; when last day falls on holiday.—Where the day, or the last day, for doing any act herein required or permitted to be done falls on Sunday or on a holiday, the act may be done on the next succeeding secular or business day.

§6. Application of chapter.—The provisions of this act do not apply to negotiable instruments made and delivered prior to the passage hereof.

§7. Law merchant; when governs.—In any case not provided for in this act the rules of the law merchant shall govern.

ARTICLE II.

FORM AND INTERPRETATION.

§20. Form of negotiable instrument.
§21. Certainty as to sum; what constitutes.
§22. When promise is unconditional.
§23. Determinable future time; what constitutes.
§24. Additional provisions not affecting negotiability.
§25. Omissions; seal; particular money.
§26. When payable on demand.
§27. When payable to order.
§28. When payable to bearer.
§29. Terms, when sufficient.
§30. Date, presumption as to.
§31. Ante-dated and post-dated.
§32. When date may be inserted.
§33. Blanks, when may be filled.
§34. Incomplete instrument not delivered.
§35. Delivery; when effectual; when presumed.
§36. Construction where instrument is ambiguous.
§37. Liability of person signing in trade or assumed name.
§38. Signature by agent; authority; how shown
§39. Liability of person signing as agent, et cetera.
§40. Signature by procuration; effect of.
§41. Effect of indorsement by infant or corporation
§42. Forged signature; effect of.

§20. Form of negotiable instrument.—An instrument to be negotiable must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer;

2. Must contain an unconditional promise or order to pay a sum certain in money;

3. Must be payable on demand, or at a fixed or determinable future time;

4. Must be payable to order or to bearer; and

5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

§21. Certainty as to sum; what constitutes.—The sum payable is a sum certain within the meaning of this act, although it is to be paid;

1. With interest; or

2. By stated instalments; or

3. By stated instalments, with a provision that upon default in payment of any instalment or of interest, the whole shall become due; or

4. With exchange, whether at a fixed rate or at the current rate; or

5. With costs of collection or an attorney's fee, in case payment shall not be made at maturity.

§22. When promise is unconditional.—An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with:

1. An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or

2. A statement of the transaction which gives rise to the instrument.

But an order or promise to pay out of a particular fund is not unconditional.

§23. Determinable future time; what constitutes.—An instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable:

1. At a fixed period after date or sight; or

2. On or before a fixed or determinable future time specified therein; or

3. On or at a fixed period after the occurrence of a specified event, which is certain to happen, though the time of happening be uncertain.

An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect.

§24. Additional provisions not affecting negotiability.—An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable but the negotiable character of an instrument otherwise negotiable is not affected by a provision which:

1. Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or
2. Authorizes a confession of judgment if the instrument be not paid at maturity; or
3. Waives the benefit of any law intended for the advantage or protection of the obligor; or
4. Gives the holder an election to require something to be done in lieu of payment of money.

But nothing in this section shall validate any provision or stipulation otherwise illegal.

§25. Omissions; seal; particular money.—The validity and negotiable character of an instrument are not affected by the fact that:

1. It is not dated; or
2. Does not specify the value given, or that any value has been given therefor; or
3. Does not specify the place where it is drawn or the place where it is payable; or
4. Bears a seal; or
5. Designates a particular kind of current money in which payment is to be made.

But nothing in this section shall alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument.

§26. When payable on demand.—An instrument is payable on demand:

1. Where it is expressed to be payable on demand, or at sight, or on presentation; or
2. In which no time for payment is expressed.

Where an instrument is issued, accepted or indorsed when overdue, it is, as regards the person so issuing, accepting or indorsing it, payable on demand.

§27. When payable to order.—The instrument is payable to order where it is drawn payable to the order of a specified person or to him or his order. It may be drawn payable to the order of:

1. A payee who is not maker, drawer or drawee; or
2. The drawer or maker; or
3. The drawee;
4. Two or more payees jointly; or
5. One or some of several payees; or
6. The holder of an office for the time being.

Where the instrument is payable to order, the payee must be named or otherwise indicated therein with reasonable certainty.

§28. When payable to bearer.—The instrument is payable to bearer:

1. When it is expressed to be so payable; or
2. When it is payable to a person named therein or bearer; or
3. When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable; or
4. When the name of the payee does not purport to be the name of any person; or
5. When the only or last indorsement is an indorsement in blank.

§29. Terms when sufficient.—The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof.

§30. Date, presumption as to.—Where the instrument or an acceptance or any indorsement thereon is dated, such date is deemed *prima facie* to be the true date of the making, drawing, acceptance or indorsement, as the case may be.

§31. Ante-dated and post-dated.—The instrument is not invalid for the reason only that it is ante-dated or post-dated, provided this is not done for an illegal or fraudulent purpose. The person to whom an instrument so dated is delivered acquires the title thereto as of the date of delivery.

§32. When date may be inserted.—Where an instrument expressed to be payable at a fixed period after date is issued undated, or where the acceptance of an instrument payable at a fixed period after sight is undated, any holder may insert therein the true date of issue or ac-

ceptance, and the instrument shall be payable accordingly. The insertion of a wrong date does not avoid the instrument in the hands of a subsequent holder in due course; but as to him, the date so inserted is to be regarded as the true date.

§33. Blanks; when may be filled.—Where the instrument is wanting in any material particular, the person in possession thereof has a *prima facie* authority to complete it by filling up the blanks therein. And a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a *prima facie* authority to fill it up as such for any amount. In order, however, that any such instrument, when completed, may be enforced against any person who became a party thereto prior to its completion, it must be filled up strictly in accordance with the authority given and within a reasonable time. But if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time.

§34. Incomplete instrument not delivered.—Where an incomplete instrument has not been delivered it will not, if completed and negotiated, without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery.

§35. Delivery; when effectual; when presumed.—Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. As between immediate parties, and as regards a remote party other than a holder in due course, the delivery, in order to be effectual, must be made either by or under the authority of the party making, drawing, accepting or indorsing, as the case may be; and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed. And where the instrument is no longer in the possession of a party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved.

§36. Construction where instrument is ambiguous.—Where the language of the instrument is ambiguous, or there are omissions therein, the following rules of construction apply:

1. Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, reference may be had to the figures to fix the amount;

2. Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof;

3. Where the instrument is not dated, it will be considered to be dated as of the time it was issued;

4. Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail;

5. Where the instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it as either at his election;

6. Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser;

7. Where an instrument containing the words "I promise to pay" is signed by two or more persons, they are deemed to be jointly and severally liable thereon.

§37. Liability of person signing in trade or assumed name.—No person is liable on the instrument whose signature does not appear thereon, except as herein otherwise expressly provided. But one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name.

§38. Signature by agent; authority; how shown.—The signature of any party may be made by a duly authorized agent. No particular form of appointment is necessary for this purpose; and the authority of the agent may be established as in other cases of agency.

§39. Liability of person signing as agent, etc.—Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not liable on the instrument if he was duly authorized; but the

mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.

§40. Signature by procuration; effect of.—A signature by "procuration" operates as notice that the agent has but a limited authority to sign, and the principal is bound only in case the agent in so signing acted within the actual limits of his authority.

§41. Effect of indorsement by infant or corporation.—The indorsement or assignment of the instrument by a corporation or by an infant passes the property therein, notwithstanding that from want of capacity the corporation or infant may incur no liability thereon.

§42. Forged signature; effect of.—Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority.

ARTICLE III.

CONSIDERATION OF NEGOTIABLE INSTRUMENTS.

§50. Presumption of consideration.
§51. What constitutes consideration.
§52. What constitutes holder for value.
§53. When lien on instrument constitutes holder for value.
§54. Effect of want of consideration.
§55. Liability of accommodation party.

§50. Presumption of consideration.—Every negotiable instrument is deemed *prima facie* to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value.

§51. Consideration; what constitutes.—Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing

debt constitutes value; and is deemed such whether the instrument is payable on demand or at a future time.

§52. What constitutes holder for value.—Where value has at any time been given for the instrument, the holder is deemed a holder for value in respect to all parties who became such prior to that time.

§53. When lien on instrument constiutes holder for value.—Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value, to the extent of his lien.

§54. Effect of want of consideration.—Absence or failure of consideration is matter of defense as against any person not a holder in due course; and partial failure of consideration is a defense *protanto,* whether the failure is an ascertained and liquidated amount or otherwise.

§55. Liability of accommodation party.—An accommodation party is one who has signed the instrument as maker, drawer, acceptor or indorser, without receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party.

ARTICLE IV.

NEGOTIATION.

§60. What constitutes negotiation.
§61. Indorsement; how made.
§62. Indorsement must be of entire instrument.
§63. Kinds of indorsement.
§64. Special indorsement; indorsement in blank.
§65. Blank indorsement; how changed to special indorsement.
§66. When indorsement restrictive.
§67. Effect of restrictive indorsement; rights of indorsee.
§68. Qualified indorsement.
§69. Conditional indorsement.

§70. Indorsement of instrument payable to bearer.
§71. Indorsement where payable to two or more persons.
§72. Effect of instrument drawn or indorsed to a person as cashier.
§73. Indorsement where name is misspelled, et. cetera.
§74. Indorsement in representative capacity.
§75. Time of indorsement; presumption.
§76. Place of indorsement; presumption.
§77. Continuation of negotiable character.
§78. Striking out indorsement.
§79. Transfer without indorsement; effect of.
§80. When prior party may negotiate instrument.

§60. What constitutes negotiaton.—An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery, if payable to order it is negotiated by the indorsement of the holder completed by delivery.

§61. Indorsement; how made.—The indorsement must be written on the instrument itself or upon a paper attached thereto. The signature of the indorser, without additional words, is a sufficient indorsement.

§62. Indorsement must be of entire instrument.—The indorsement must be an indorsement of the entire instrument. An indorsement which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more indorsees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue.

§63. Kinds of indorsement.—An indorsement may be either special or in blank; and it may also be either restrictive or qualified, or conditional.

§64. Special indorsement; indorsement in blank.—A special indorsement specifies the person to whom, or to whose order the instrument is to be payable; and the indorsement of such indorsee is necessary to the further negotiation of the instrument. An indorsement in blank specifies no indorsee, and an instrument so indorsed is payable to bearer, and may be negotiated by delivery.

§65. **Blank indorsement; how changed to special indorsement.**—The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.

§66. **When indorsement restrictive.**—An indorsement is restrictive, which either:

1. Prohibits the further negotiation of the instrument; or
2. Constitutes the indorsee the agent of the indorser; or
3. Vests the title in the indorsee in trust for or to the use of some other person.

But the mere absence of words implying power to negotiate does not make an indorsement restrictive.

§67. **Effect of restrictive indorsement; rights of indorsee.**—A restrictive indorsement confers upon the indorsee the right:

1. To receive payment of the instrument;
2. To bring any action thereon that the indorser could bring;
3. To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.

But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement.

§68. **Qualified indorsement.**—A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument. It may be made by adding to the indorser's signature the words "without recourse" or any words of similar import. Such an indorsement does not impair the negotiable character of the instrument.

§69. **Conditional indorsement.**—Where an indorsement is conditional a party required to pay the instrument may disregard the condition and make payment to the indorsee or his transferee, whether the condition has been fulfilled or not. But any person to whom an instrument so indorsed is negotiated will hold the same, or the proceeds thereof, subject to the rights of the person indorsing conditionally.

§70. **Indorsement of instrument payable to bearer.**—Where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery; but the person indorsing specially

is liable as indorser to only such holders as make title through his indorsement.

§71. **Indorsement where payable to two or more persons.**—Where an instrument is payable to the order of two or more payees or indorsees who are not partners, all must indorse, unless the one indorsing has authority to indorse for the others.

§72. **Effect of instrument drawn or indorsed to a person as cashier.**—Where an instrument is drawn or indorsed to a person as "cashier" or other fiscal officer of a bank or corporation, it is deemed *prima facie* to be payable to the bank or corporation of which he is such officer; and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer.

§73. **Indorsement where name is misspelled, et cetera.**—Where the name of a payee or indorsee is wrongly designated or misspelled, he may indorse the instrument as therein described, adding, if he thinks fit, his proper signature.

§74. **Indorsement in representative capacity.**—Where any person is under obligation to indorse in a representative capacity, he may indorse in such terms as to negative personal liability.

§75. **Time of indorsement; presumption.**—Except where an indorsement bears date after the maturity of the instrument every negotiation is deemed *prima facie* to have been effected before the instrument was overdue.

§76. **Place of indorsement; presumption.**—Except where the contrary appears every indorsement is presumed *prima facie* to have been made at the place where the instrument is dated.

§77. **Continuation of negotiable character.**—An instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed or discharged by payment or otherwise.

§78. **Striking out indorsement.**—The holder may at any time strike out any indorsement which is not necessary to his title. The indorser whose indorsement is struck out, and all indorsers subsequent to him, are thereby relieved from liability on the instrument.

§79. Transfer without indorsement; effect of.—Where the holder of an instrument payable to his order transfers it for value without indorsing it, the transfer vests in the transferee such title as the transferror had therein, and the transferee acquires, in addition, the right to have the indorsement of the transferror. But for the purpose of determining whether the transferee is a holder in due course, the negotiation takes effect as of the time when the indorsement is actually made.

§80. When prior party may negotiate instrument.—Where an instrument is negotiated back to a prior party, such party may, subject to the provisions of this act, reissue and further negotiate the same. But he is not entitled to enforce payment thereof against any intervening party to whom he was personally liable.

ARTICLE V.

RIGHTS OF HOLDER.

§90. Right of holder to sue; payment.
§91. What constitutes a holder in due course.
§92. When person not deemed holder in due course.
§93. Notice before full amount paid.
§94. When title defective.
§95. What constitutes notice of defect.
§96. Rights of holder in due course.
§97. When subject to original defenses.
§98. Who deemed holder in due course.

§90. Right of holder to sue; payment.—The holder of a negotiable instrument may sue thereon in his own name; and payment to him in due course discharges the instrument.

§91. What constitutes a holder in due course.—A holder in due course is a holder who has taken the instrument under the following conditions:

1. That it is complete and regular upon its face;
2. That he became the holder, of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact.
3. That he took it in good faith and for value;
4. That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

§92. When person not deemed holder in due course.—Where an instrument payable on demand is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course.

§93. Notice before full amount paid.—Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him.

§94. When title defective.—The title of a person who negotiates an instrument is defective within the meaning of this act when he obtains the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

§95. What constitutes notice of defect.—To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

§96. Rights of holder in due course.—A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

§97. When subject to original defenses.—In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter.

§98. Who deemed holder in due course.—Every holder is deemed *prima facie* to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective,

the burden is on the holder to prove that he or some person under whom he claims acquired the title as a holder in due course. But the last-mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of such defective title.

ARTICLE VI.

LIABILITY OF PARTIES.

§110. Liability of maker.
§111. Liability of drawer.
§112. Liability of acceptor.
§113. When person deemed indorser.
§114. Liability of irregular indorser.
§115. Warranty; where negotiation by delivery, et cetera.
§116. Liability of general indorsers.
§117. Liability of indorser where paper negotiable by delivery.
§118. Order in which indorsers are liable.
§119. Liability of agent or broker.

§110. Liability of maker.—The maker of a negotiable instrument by making it engages that he will pay it according to its tenor; and admits the existence of the payee and his then capacity to indorse.

§111. Liability of drawer.—The drawer by drawing the instrument admits the existence of the payee and his then capacity to indorse; and engages that on due presentment the instrument will be accepted and paid, or both, according to its tenor, and that if it be dishonored and the necessary proceedings of dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it. But the drawer may insert in the instrument an express stipulation negativing or limiting his own liability to the holder.

§112. Liability of acceptor.—The acceptor by accepting the instrument engages that he will pay it according to the tenor of his acceptance; and admits:

1. The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument; and
2. The existence of the payee and his then capacity to indorse.

§113. When person deemed indorser.—A person placing his signature upon an instrument otherwise than as maker, drawer or acceptor is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity.

§114. Liability of irregular indorser.—Where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser in accordance with the following rules:

1. If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties.
2. If the instrument is payable to the order of the maker or drawer, or is payable to bearer, he is liable to all parties subsequent to the maker or drawer.
3. If he signs for the accommodation of the payee he is liable to all parties subsequent to the payee.

§115. Warranty where negotiation by delivery, et cetera.—Every person negotiating an instrument by delivery or by a qualified indorsement, warrants:

1. That the instrument is genuine and in all respects what it purports to be;
2. That he has a good title to it;
3. That all prior parties had capacity to contract;
4. That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless.

But when the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee. The provision of subdivision three of this section does not apply to persons negotiating public or corporate securities, other than bills and notes.

§116. Liability of general indorser.—Every indorser who indorses without qualification, warrants to all subsequent holders in due course:

1. The matter and things mentioned in subdivisions one, two and three of the next preceding section; and
2. That the instrument is at the time of his indorsement valid and subsisting.

And, in addition, he engages that on due presentment, it shall be accepted or paid, or both, as the case may be, according to its tenor, and that if it be dishonored, and the necessary proceedings on dis-

honor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it.

§117. Liability of indorser where paper negotiable by delivery.—Where a person places his indorsement on an instrument negotiable by delivery he incurs all the liabilities of an indorser.

§118. Order in which indorsers are liable.—As respects one another, indorsers are liable *prima facie* in the order in which they indorse; but evidence is admissible to show that as between or among themselves they have agreed otherwise. Joint payees or joint indorsees who indorse are deemed to indorse jointly and severally.

§119. Liability of agent or broker.—Where a broker or other agent negotiates an instrument without indorsement, he incurs all the liabilities prescribed by section one hundred and fifteen of this act, unless he discloses the name of his principal, and the fact that he is acting only as agent.

ARTICLE VII.

PRESENTMENT FOR PAYMENT.

§130. Effect of want of demand on principal debtor.
§131. Presentment where instrument is not payable on demand.
§132. What constitutes a sufficient presentment.
§133. Place of presentment.
§134. Instrument must be exhibited.
§135. Presentment where instrument payable at bank.
§136. Presentment where principal debtor is dead.
§137. Presentment to persons liable as partners.
§138. Presentment to joint debtors.
§139. When presentment not required to charge the drawer.
§140. When presentment not required to charge the indorser.
§141. When delay in making presentment is excused.
§142. When presentment may be dispensed with.
§143. When instrument dishonored by non-payment.
§144. Liability of person secondarily liable, when instrument dishonored.
§145. Time of maturity.

§146. Time; how computed.
§147. Rule where instrument payable at bank.
§148. What constitutes payment in due course.

§130. Effect of want of demand on principal debtor.—Presentment for payment is not necessary in order to charge the person primarily liable on the instrument; but if the instrument is, by its terms, payable at a special place, and he is able and willing to pay it there at maturity and has funds there available for that purpose, such abiilty and willingness are equivalent to a tender of payment upon his part. But except as herein otherwise provided, presentment for payment is necessary in order to charge the drawer and indorsers.

§131. Presentment where instrument is not payable on demand.—Where the instrument is not payable on demand, presentment must be made on the day it falls due. Where it is payable on demand, presentment must be made within a reasonable time after its issue, except that in case of a bill of exchange, presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof.

§132. What constitutes a sufficient presentment.—Presentment for payment, to be sufficient, must be made:

1. By the holder, or by some person authorized to receive payment on his behalf;
2. At a reasonable hour on a business day;
3. At a proper place as herein defined;
4. To the person primarily liable on the instrument, or if he is absent or inaccessible, to any person found at the place where the presentment is made.

§133. Place of presentment.—Presentment for payment is made at the proper place:

1. Where a place of payment is specified in the instrument and it is there presented;
2. Where no place of payment is specified, but the address of the person to make payment is given in the instrument and it is there presented;
3. Where no place of payment is specified and no address is given and the instrument is presented at the usual place of business or residence of the person to make payment.

4. In any other case if presented to the person to make payment wherever he can be found, or if presented at his last known place of business or residence.

§134. Instrument must be exhibited.—The instrument must be exhibited to the person from whom payment is demanded, and when it is paid must be delivered up to the party paying it.

§125. Presentment where instrument payable at bank.—Where the instrument is payable at a bank, presentment for payment must be made during banking hours, unless the person to make payment has no funds there to meet it at any time during the day, in which case presentment at any hour before the bank is closed on that day is sufficient.

§136. Presentment where principal debtor is dead.—Where the person primarily liable on the instrument is dead, and no place of payment is specified, presentment for payment must be made to his personal representative, if such there be, and if with the exercise of reasonable diligence, he can be found.

§137. Presentment to persons liable as partners.—Where the persons primarily liable on the instrument are liable as partners, and no place of payment is specified, presentment for payment may be made to any one of them, even though there has been a dissolution of the firm.

§138. Presentment to joint debtors.—Where there are several persons not partners, primarily liable on the instrument, and no place of payment is specified, presentment must be made to them all.

§139. When presentment not required to charge the drawer.—Presentment for payment is not required in order to charge the drawer where he has not right to expect or require that the drawee or acceptor will pay instrument.

§140. When presentment not required to charge the indorser.—Presentment for payment is not required in order to charge an indorser where the instrument was made or accepted for his accommodation, and he has no reason to expect that the instrument will be paid if presented.

§141. When delay in making presentment is excused.—Delay in making presentment for payment is excused when the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, presentment must be made with reasonable diligence.

§142. When presentment may be dispensed with.—Presentment for payment is dispensed with:

1. Where after the exercise of reasonable diligence presentment as required by this act cannot be made;
2. Where the drawee is a fictitious person;
3. By waiver of presentment express or implied.

§143. When instrument dishonored by non-payment.—The instrument is dishonored by non-payment when:

1. It is duly presented for payment and payment is refused or cannot be obtained; or
2. Presentment is excused and the instrument is overdue and unpaid.

§144. Liability of person secondarily liable, when instrument dishonored.—Subject to the provisions of this act, when the instrument is dishonored by non-payment, an immediate right of recourse to all parties secondarily liable thereon, accrues to the holder.

§145. Time of maturity.—Every negotiable instrument is payable at the time fixed therein without grace. When the day of maturity falls upon Sunday or a holiday, the instrument is payable on the next succeeding business day. Instruments falling due or becoming payable on Saturday are to be presented for payment on the next succeeding business day, except that instruments payable on demand may, at the option of the holder, be presented for payment before 12 o'clock noon on Saturday when that entire day is not a holiday.

§146. Time; how computed.—Where the instrument is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the date of payment.

§147. Rule where instrument payable at bank.—Where an instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon.

§148. What constitutes payment in due course.—Payment is made in due course when it is made at or after the maturity of the instrument to the holder thereof in good faith and without notice that his title is defective.

ARTICLE VIII.

NOTICE OF DISHONOR.

§160. To whom notice of dishonor must be given.
§161. By whom given.
§162. Notice given by agent.
§163. Effect of notice given on behalf of holder.
§164. Effect where notice is given by party entitled thereto.
§165. When agent may give notice.
§166. When notice sufficient.
§167. Form of notice.
§168. To whom notice may be given.
§169. Notice where party is dead.
§170. Notice to partners.
§171. Notice to persons jointly liable.
§172. Notice to bankrupt.
§173. Time within which notice must be given.
§174. Where parties reside in same place.
§175. Where parties reside in different places.
§176. When sender deemed to have given due notice.
§177. Deposit in post-office, what constitutes.
§178. Notice to subsequent parties, time of.
§179. Where notice must be sent.
§180. Waiver of notice.
§181. Whom affected by waiver.
§182. Waiver of protest.
§183. When notice dispensed with.
§184. Delay in giving notice; how excused.
§185. When notice need not be given to drawer.
§186. When notice need not be given to indorser.

§187. Notice of non-payment where acceptance refused.
§188. Effect of omission to give notice of non-acceptance.
§189. When protest need not be made; when must be made.

§160. To whom notice of dishonor must be given.—Except as herein otherwise provided, when a negotiable instrument has been dishonored by non-acceptance or non-payment, notice of dishonor must be given to the drawer and to each indorser, and any drawer or indorser to whom such notice is not given is discharged.

§161. By whom given.—The notice may be given by or on behalf of the holder, or by or on behalf of any party to the instrument who might be compelled to pay it to the holder, and who, upon taking it up, would have a right to reimbursement from the party to whom the notice is given.

§162. Notice given by agent.—Notice of dishonor may be given by an agent either in his own name or in the name of any party entitled to give notice whether that party be his principal or not.

§163. Effect of notice given on behalf of holder.—Where notice is given by or on behalf of the holder, it inures for the benefit of all subsequent holders and all prior parties who have a right of recourse against the party to whom it is given.

§164. Effect where notice is given by party entitled thereto.—Where notice is given by or on behalf of a party entitled to give notice, it inures for the benefit of the holder and all parties subsequent to the party to whom notice is given.

§165. When agent may give notice.—Where the instrument has been dishonored in the hands of an agent, he may either himself give notice to the parties liable thereon, or he may give notice to his principal. If he give notice to his principal, he must do so within the same time as if he were the holder, and the principal, upon the receipt of such notice, has himself the same time for giving notice as if the agent had been an independent holder.

§166. When notice sufficient.—A written notice need not be signed, and an insufficient written notice may be supplemented and validated

by verbal communication. A misdescription of the instrument does not vitiate the notice unless the party to whom the notice is given is in fact misled thereby.

§167. **Form of notice.**—The notice may be in writing or merely oral, and may be given in any terms which sufficiently identify the instrument, and indicate that it has been dishonored by non-acceptance or non-payment. It may in all cases be given by delivering it personally or through the mails.

§168. **To whom notice may be given.**—Notice of dishonor may be given either to the party himself or to his agent in that behalf.

§169. **Notice where party is dead.**—When any party is dead, and his death is known to the party giving notice, the notice must be given to a personal representative, if there be one, and if with reasonable diligence he can be found. If there be no personal representative, notice may be sent to the last residence or last place of business of the deceased.

§170. **Notice to partners.**—Where the parties to be notified are partners, notice to any one partner is notice to the firm, even though there has been a dissolution.

§171. **Notice to persons jointly liable.**—Notice to joint parties who are not partners must be given to each of them, unless one of them has authority to receive such notice for the others.

§172. **Notice to bankrupt.**—Where a party has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, notice may be given either to the party himself or to his trustee or assignee.

§173. **Time within which notice must be given.**—Notice may be given as soon as the instrument is dishonored; and unless delay is excused as hereinafter provided, must be given within the times fixed by this act.

§174. **Where parties reside in same place.**—Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times:

1. If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following;

2. If given at his residence, it must be given before the usual hours of rest on the day following;

3. If sent by mail, it must be deposited in the post-office in time to reach him in usual course on the day following.

§175. Where parties reside in different places.—Where the person giving and the person to receive notice reside in different places, the notice must be given within the following times:

1. If sent by mail, it must be deposited in the post-office in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on that day, by the next mail thereafter.

2. If given otherwise than through the post-office, then within the time that notice would have been received in due course of mail, if it had been deposited in the post-office within the time specified in the last subdivision.

§176. When sender deemed to have given due notice.—Where notice of dishonor is duly addressed and deposited in the post-office, the sender is deemed to have given due notice, notwithstanding any miscarriage in the mails.

§177. Deposit in post-office; what constitutes.—Notice is deemed to have been deposited in the post-office when deposited in any branch post-office or in any letter-box under the control of the post-office department.

§178. Notice to antecedent party; time of.—Where a party receives notice of dishonor, he has, after the receipt of such notice, the same time for giving notice to antecedent parties that the holder has after the dishonor.

§179. Where notice must be sent.—Where a party has added an address to his signature, notice of dishonor must be sent to that address; but if he has not given such address, then the notice must be sent as follows:

1. Either to the post-office nearest to his place of residence, or to the post-office where he is accustomed to receive his letters; or

2. If he live in one place, and have his place of business in another, notice may be sent to either place; or

3. If he is sojourning in another place, notice may be sent to the place where he is so sojourning.

But where the notice is actually received by the party within the time specified in this act, it will be sufficient, though not sent in accordance with the requirements of this section.

§180. **Waiver of notice.**—Notice of dishonor may be waived, either before the time of giving notice has arrived or after the omission to give due notice, and the waiver may be express or implied.

§181. **Whom affected by waiver.**—Where the waiver is embodied in the instrument itself, it is binding upon all parties; but where it is written above the signature of an indorser, it binds him only.

§182. **Waiver of protest.**—A waiver of protest, whether in the case of a foreign bill of exchange or other negotiable instrument, is deemed to be a waiver not only of a formal protest, but also of presentment and notice of dishonor.

§183. **When notice is dispensed with.**—Notice of dishonor is dispensed with when, after the exercise of reasonable diligence, it cannot be given to or does not reach the parties sought to be charged.

§184. **Delay in giving notice; how excused.**—Delay in giving notice of dishonor is excused when the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, notice must be given with reasonable diligence.

§185. **When notice need not be given to drawer.**—Notice of dishonor is not required to be given to the drawer in either of the following cases:

1. Where the drawer and drawee are the same person;

2. Where the drawee is a fictitious person or a person not having capacity to contract;

3. Where the drawer is the person to whom the instrument is presented for payment;

4. Where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument;
5. Where the drawer has countermanded payment.

§186. When notice need not be given to indorser.—Notice of dishonor is not required to be given to an indorser in either of the following cases:
1. Where the drawee is a fictitious person or a person not having capacity to contract, and the indorser was aware of the fact at the time he indorsed the instrument;
2. Where the indorser is the person to whom the instrument is presented for payment;
3. Where the instrument was made or accepted for his accommodation.

§187. Notice of non-payment where acceptance refused.—Where due notice of dishonor by non-acceptance has been given, notice of a subsequent dishonor by non-payment is not necessary unless in the meantime the instrument has been accepted.

§188. Effect of omission to give notice of non-acceptance.—An omission to give notice of dishonor by non-acceptance does not prejudice the rights of a holder in due course subsequent to the omission.

§189. When protest need not be made; when must be made.—Where any negotiable instrument has been dishonored it may be protested for non-acceptance or non-payment, as the case may be; but protest is not required, except in the case of foreign bills of exchange.

ARTICLE IX.

DISCHARGE OF NEGOTIABLE INSTRUMENTS.

§200. Instrument; how discharged.
§201. When person secondarily liable on, discharged.
§202. Right of party who discharges instrument.
§203. Renunciation by holder.
§204. Cancellation; unintentional; burden of proof.
§205. Alteration of instrument; effect of.
§206. What constitutes a material alteration.

§200. How instrument discharged.—A negotiable instrument is discharged:

1. By payment in due course by or on behalf of the principal debtor;

2. By payment in due course by the party accommodated, where the instrument is made or accepted for accommodation;

3. By the intentional cancellation thereof by the holder;

4. By any other act which will discharge a simple contract for the payment of money;

5. When the principal debtor becomes the holder of the instrument at or after maturity in his own right.

§201. When persons secondarily liable on, discharged.—A person secondarily liable on the instrument is discharged:

1. By any act which discharges the instrument;

2. By the intentional cancellation of his signature by the holder;

3. By the discharge of a prior party;

4. By a valid tender of payment made by a prior party;

5. By a release of the principal debtor, unless the holder's right of recourse against the party secondarily liable is expressly reserved;

6. By any agreement binding upon the holder to extend the time of payment or to postpone the holder's right to enforce the instrument, (unless made with the assent of the party secondarily liable, or) unless the right of recourse against such party is expressly reserved.

§202. Right of party who discharges instrument.—Where the instrument is paid by a party secondarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument, except:

1. Where it is payable to the order of a third person, and has been paid by the drawer; and

2. Where it was made or accepted for accommodation, and has been paid by the party accommodated.

§203. Renunciation by holder.—The holder may expressly renounce his rights against any party to the instrument, before, at or after its maturity. An absolute and unconditional renunciation of his rights against the principal debtor made at or after the maturity of the instrument, discharges the instrument. But a renunciation does not

affect the rights of a holder in due course without notice. A renunciation must be in writing, unless the instrument is delivered up to the person primarily liable thereon.

§204. Cancellation; unintentional; burden of proof.—A cancellation made unintentionally, or under a mistake, or without the authority of the holder, is inoperative; but where an instrument or any signature thereon appears to have been cancelled the burden of proof lies on the party who alleges that the cancellation was made unintentionally, or under a mistake or without authority.

§205. Alteration of instrument; effect of.—Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided except as against a party who has himself made, authorized or assented to the alteration and subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor.

§206. What constitutes a material alteration.—Any alteration which changes:

1. The date;
2. The sum payable, either for principal or interest;
3. The time or place of payment;
4. The number or the relations of the parties;
5. The medium or currency in which payment is to be made;

Or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect, is a material alteration.

ARTICLE X.

BILLS OF EXCHANGE; FORM AND INTERPRETATION.

§210. Bill of exchange defined.
§211. Bill not an assignment of funds in hands of drawee.
§212. Bill addressed to more than one drawee.
§213. Inland and foreign bills of exchange.
§214. When bill may be treated as promissory note.
§215. Referee in case of need.

§210. Bill of exchange defined.—A bill of exchange is an unconditional order in writing addressed by any person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.

§211. Bill not an assignment of funds in hands of drawee.—A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.

§212. Bill adressed to more than one drawee.—A bill may be addressed to two or more drawees jointly, whether they are partners or not; but not to two or more drawees in the alternative or in the succession.

§213. Inland and foreign bills of exchange.—An inland bill of exchange is a bill which is, or on its face purports to be, both drawn and payable within this State. Any other bill is a foreign bill. Unless the contrary appears on the face of the bill, the holder may treat it as an inland bill.

§214. When bill may be treated as promissory note.—Where in a bill the drawer and drawee are the same person, or where the drawee is a fictitious person, or a person not having capacity to contract, the holder may treat the instrument, at his option, either as a bill of exchange or a promissory note.

§215. Referee in case of need.—The drawer of a bill and any indorser may insert thereon the name of a person to whom the holder may resort in case of need, that is to say, in case the bill is dishonored by non-acceptance or non-payment. Such person is called the referee in case of need. It is in the option of the holder to resort to the referee in case of need or not as he may see fit.

ARTICLE XI.

ACCEPTANCE OF BILLS OF EXCHANGE.

§220. Acceptance, how made, et cetera.
§221. Holder entitled to acceptance on face of bill.
§222. Acceptance by separate instrument.
§223. Promise to accept; when equivalent to acceptance.

§224. Time allowed drawee to accept.
§225. Liability of drawee retaining or destroying bill.
§226. Acceptance of incomplete bill.
§227. Kinds of acceptances.
§228. What constitutes a general acceptance.
§229. Qualified acceptance.
§230. Rights of parties as to qualified acceptance.

§220. Acceptance; how made, et cetera.—The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promise by any other means than the payment of money.

§221. Holder entitled to acceptance on face of bill.—The holder of a bill presenting the same for acceptance may require that the acceptance be written on the bill, and if such request is refused, may treat the bill as dishonored.

§222. Acceptance by separate instrument.—Where an acceptance is written on a paper other than the bill itself, it does not bind the acceptor, except in favor of a person to whom it is shown and who, on the faith thereof, receives the bill for value.

§223. Promise to accept; when equivalent to acceptance.—An unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person, who, upon the faith thereof, receives the bill for value.

§224. Time allowed drawee to accept.—The drawee is allowed twenty-four hours after presentment in which to decide whether or not he will accept the bill; but the acceptance if given dates as of the day of presentation.

§225. Liability of drawee retaining or destroying bill.—Where a drawee to whom a bill is delivered for acceptance destroys the same, or refuses within twenty-four hours after such delivery, or within such other period as the holder may allow, to return the bill accepted or non-accepted to the holder, he will be deemed to have accepted the same.

§226. **Acceptance of incomplete bill.**—A bill may be accepted before it has been signed by the drawer, or while otherwise incomplete, or when it is overdue, or after it has been dishonored by a previous refusal to accept, or by non-payment. But when a bill payable after sight is dishonored by non-acceptance and the drawee subsequently accepts it, the holder, in the absence of any different agreement, is entitled to have the bill accepted as of the date of the first presentment.

§227. **Kinds of acceptance.**—An acceptance is either general or qualified. A general acceptance assents without qualification to the order of the drawer. A qualified acceptance in express terms varies the effect of the bill as drawn.

§228. **What constitutes a general acceptance.**—An acceptance to pay at a particular place is a general acceptance unless it expressly states that the bill is to be paid there only and not elsewhere.

§229. **Qualified acceptance.**—An acceptance is qualified which is:

1. Conditional, that is to say, which makes payment by the acceptor dependent on the fulfillment of a condition therein stated;
2. Partial, that is to say, an acceptance to pay part only of the amount for which the bill is drawn;
3. Local, that is to say, an acceptance to pay only at a particular place;
4. Qualified as to time;
5. The acceptance of some one or more of the drawees, but not of all.

§230. **Rights of parties as to qualified acceptance.**—The holder may refuse to take a qualified acceptance, and if he does not obtain an unqualified acceptance, he may treat the bill as dishonored by non-acceptance. Where a qualified acceptance is taken, the drawer and indorsers are discharged from liability on the bill, unless they have expressly or impliedly authorized the holder to take a qualified acceptance, or subsequently assent thereto. When the drawer or an indorser receives notice of a qualified acceptance, he must within a reasonable time express his dissent to the holder, or he will be deemed to have assented thereto.

ARTICLE XII.

PRESENTMENT OF BILLS OF EXCHANGE FOR ACCEPTANCE.

§240. When presentment for acceptance must be made.
§241. When failure to present releases drawer and indorser.
§242. Presentment; how made.
§243. On what days presentment may be made.
§244. Presentment; where time is insufficient.
§245. When presentment is excused.
§246. When dishonored by non-acceptance.
§247. Duty of holder where bill not accepted.
§248. Rights of holder where bill not accepted.

§240. When presentment for acceptance must be made.—Presentment for acceptance must be made:

1. Where the bill is payable after sight or in any other case where presentment for acceptance is necessary in order to fix the maturity of the instrument; or

2. Where the bill expressly stipulates that it shall be presented for acceptance; or

3. Where the bill is drawn payable elsewhere than at the residence or place of business of the drawee.

In no other case is presentment for acceptance necessary in order to render any party to the bill liable.

§241. When failure to present releases drawer and indorser.—Except as herein otherwise provided, the holder of a bill which is required by the next preceding section to be presented for acceptance must either present it for acceptance or negotiate it within a reasonable time. If he fails to do so, the drawer and all indorsers are discharged.

§242. Presentment; how made.—Presentment for acceptance must be made by or on behalf of the holder at a reasonable hour, on a business day, and before the bill is overdue, to the drawee or some person authorized to accept or refuse acceptance on his behalf; and

1. Where a bill is addressed to two or more drawees who are not partners, presentment must be made to them all, unless one has authority to accept or refuse acceptance for all, in which case presentment may be made to him only;

2. Where the drawee is dead, presentment may be made to his personal representative;

3. Where the drawee has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, presentment may be made to him or to his trustee or assignee.

§243. **On what days presentment may be made.**—A bill may be presented for acceptance on any day on which negotiable instruments may be presented for payment under the provisions of sections one hundred and thirty-two and one hundred and forty-five of this act. When Saturday is not otherwise a holiday, presentment for acceptance may be made before twelve o'clock noon on that day.

§244. **Presentment where time is insufficient.**—Where the holder of a bill drawn payable elsewhere than at the place of business or the residence of the drawee has not time with the exercise of reasonable diligence to present the bill for acceptance before presenting it for payment on the day that it falls due, the delay caused by presenting the bill for acceptance before presenting it for payment is excused and does not discharge the drawers and indorsers.

§245. **Where presentment is excused.**—Presentment for acceptance is excused and a bill may be treated as dishonored by non-acceptance in either of the following cases:

1. Where the drawee is dead, or has absconded, or is a fictitious person or a person not having capacity to contract by bill;

2. Where after the exercise of reasonable diligence, presentment cannot be made;

3. Where, although presentment has been irregular, acceptance has been refused on some other ground.

§246. **When dishonored by non-acceptance.**—A bill is dishonored by non-acceptance:

1. When it is duly presented for acceptance, and such an acceptance as is prescribed by this act is refused or cannot be obtained; or

2. When presentment for acceptance is excused and the bill is not accepted.

§247. **Duty of holder where bill not accepted.**—Where a bill is duly presented for acceptance and is not accepted within the pre-

scribed time, the person presenting it must treat the bill as dishonored by non-acceptance or he loses the right of recourse against the drawer and indorsers.

§248. Rights of holder where bill not accepted.—When a bill is dishonored by non-acceptance, an immediate right of recourse against the drawers and indorsers accrues to the holder, and no presentment for payment is necessary.

ARTICLE XIII.

PROTEST OF BILLS OF EXCHANGE.

§260. In what cases protest necessary.
§261. Protest; how made.
§262. Protest; by whom made.
§263. Protest; when to be made.
§264. Protest; where made.
§265. Protest both for non-acceptance and non-payment.
§266. Protest before maturity where acceptor insolvent.
§267. When protest dispensed with.
§268. Protest, where bill is lost, et cetera.

§260. In what cases protest necessary.—Where a foreign bill appearing on its face to be such is dishonored by non-acceptance, it must be duly protested for non-acceptance, and where such a bill which has not previously been dishonored by non-acceptance is dishonored by non-payment, it must be duly protested for non-payment. If it is not so protested, the drawer and indorsers are discharged. Where a bill does not appear on its face to be a foreign bill, protest thereof in case of dishonor is unnecessary.

§261. Protest; how made.—The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify:

1. The time and place of presentment;
2. The fact that presentment was made and the manner thereof;
3. The cause or reason for protesting the bill;
4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found.

§262. Protest; by whom made.—Protest may be made by:

1. A notary public; or

2. By any respectable resident of the place where the bill is dishonored, in the presence of two or more credible witnesses.

§263. Protest; when to be made.—When a bill is protested, such protest must be made on the day of its dishonor, unless delay is excused as herein provided. When a bill has been duly noted, the protest may be subsequently extended as of the date of the noting.

§264. Protest; where made.—A bill must be protested at the place where it is dishonored, except that when a bill drawn payable at the place of business or residence of some person other than the drawee, has been dishonored by non-acceptance, it must be protested for non-payment at the place where it is expressed to be payable, and no further presentment for payment to, or demand on, the drawee is necessary.

§265. Protest both for non-acceptance and non-payment.—A bill which has been protested for non-acceptance may be subsequently protested for non-payment.

§266. Protest before maturity where acceptor insolvent.—Where the acceptor has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, before the bill matures, the holder may cause the bill to be protested for better security against the drawer and indorsers.

§267. When protest dispensed with.—Protest is dispensed with by any circumstances which would dispense with notice of dishonor. Delay in noting or protesting is excused when delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate, the bill must be noted or protested with reasonable diligence.

§268. Protest where bill is lost, et cetera.—When a bill is lost or destroyed or is wrongfully detained from the person entitled to hold it, protest may be made on a copy or written particulars thereof.

ARTICLE XIV.

ACCEPTANCE OF BILLS OF EXCHANGE FOR HONOR.

§280. When bill may be accepted for honor.
§281. Acceptance for honor; how made.
§282. When deemed to be an acceptance for honor of the drawer.
§283. Liability of acceptor for honor.
§284. Agreement of acceptor for honor.
§285. Maturity of bill payable after sight; accepted for honor.
§286. Protest of bill accepted for honor, et cetera.
§287. Presentment for payment to acceptor for honor; how made.
§288. When delay in making presentment is excused.
§289. Dishonor of bill by acceptor for honor.

§280. When bill may be accepted for honor.—Where a bill of exchange has been protested for dishonor by non-acceptance or protested for better security and is not overdue, any person not being a party already liable thereon may, with the consent of the holder, intervene and accept the bill *supra* protest for the honor of any party liable thereon or for the honor of the person for whose account the bill is drawn. The acceptance for honor may be for part only of the sum for which the bill is drawn, and where there has been an acceptance for honor for one party, there may be a further acceptance by a different person for the honor of another party.

§281. Acceptance for honor; how made.—An acceptance for honor *supra* protest must be in writing and indicate that it is an acceptance for honor, and must be signed by the acceptor for honor.

§282. When deemed to be an acceptance for honor of the drawer.—When an acceptance for honor does not expressly state for whose honor it is made, it is deemed to be an acceptance for the honor of the drawer.

§283. Liability of acceptor for honor.—The acceptor for honor is liable to the holder and to all parties to the bill subsequent to the party for whose honor he has accepted.

§284. Agreement of acceptor for honor.—The acceptor for honor by such acceptance engages that he will on due presentment pay the

bill according to the terms of his acceptance, provided it shall not have been paid by the drawee, and provided also that it shall have been duly presented for payment and protested for non-payment and notice of dishonor given to him.

§285. Maturity of bill payable after sight; accepted for honor.—Where a bill payable after sight is accepted for honor, its maturity is calculated from the date of the noting for non-acceptance and not from the date of the acceptance for honor.

§286. Protest of bill accepted for honor, et cetera.—Where a dishonored bill has been accepted for honor *supra* protest or contains a reference in case of need, it must be protested for non-payment before it is presented for payment to the acceptor for honor or refere in case of need.

§287. Presentment for payment to acceptor for honor; how made.—Presentment for payment to the acceptor for honor must be made as follows:

1. If it is to be presented in the place where the protest for non-payment was made, it must be presented not later than the day following its maturity;
2. If it is to be presented in some other place than the place where it was protested, then it must be forwarded within the time specified in section one hundred and seventy-five.

§288. When delay in making presentment is excused.—The provisions of section one hundred and forty-one apply where there is delay in making presentment to the acceptor for honor or referee in case of need.

§289. Dishonor of bill by acceptor for honor.—When the bill is dishonored by the acceptor for honor it must be protested for non-payment by him.

ARTICLE XV.

PAYMENT OF BILLS OF EXCHANGE FOR HONOR.

§300. Who may make payment for honor.
§301. Payment for honor; how made.

§302. Declaration before payment for honor.
§303. Preference of parties offering to pay for honor.
§304. Effect on subsequent parties where bill is paid for honor.
§305. Where holder refuses to receive payment supra protest.
§306. Rights of payer for honor.

§300. Who may make payment for honor.—Where a bill has been protested for non-payment, any person may intervene and pay it supra protest for the honor of any person liable thereon or for the honor of the person for whose account it was drawn.

§301. Payment for honor; how made.—The payment for honor supra protest in order to operate as such and not as a mere voluntary payment must be attested by a notarial act of honor, which may be appended to the protest or form an extension to it.

§302. Declaration before payment for honor.—The notarial act of honor must be founded on a declaration made by the payer for honor, or by his agent in that behalf declaring his intention to pay the bill for honor and for whose honor he pays.

§303. Preference of parties offering to pay for honor.—Where two or more persons offer to pay a bill for the honor of different parties, the person whose payment will discharge most parties to the bill is to be given the preference.

§304. Effect on subsequent parties where bill is paid for honor.—Where a bill has been paid for honor all parties subsequent to the party for whose honor it is paid are discharged, but the payer for honor is subrogated for, and succeeds to, both the rights and duties of the holder as regards the party for whose honor he pays and all parties liable to the latter.

§305. Where holder refuses to receive payment supra protest.—Where the holder of a bill refuses to receive payment supra protest, he loses his right of recourse against any party who would have been discharged by such payment.

§306. Rights of payer for honor.—The payer for honor, on paying to the holder the amount of the bill and the notarial expense incidental to its dishonor, is entitled to receive both the bill itself and the protest.

ARTICLE XVI.

BILLS IN A SET.

§310. Bills in sets constitute one bill.
§311. Rights of holders where different parts are negotiated.
§312. Liability of holder who indorses two or more parts of a set to different persons.
§313. Acceptance of bills drawn in sets.
§314. Payment by acceptor of bills drawn in sets.
§315. Effect of discharging one of a set.

§310. Bills in sets constitute one bill.—Where a bill is drawn in a set, each part of the set being numbered and containing a reference to the other parts, the whole of the parts constitutes one bill.

§311. Rights of holders where different parts are negotiated.—Where two or more parts of a set are negotiated to different holders in due course, the holder whose title first accrues is as between such holders the true owner of the bill. But nothing in this section affects the rights of a person who in due course accepts or pays the part first presented to him.

§312. Liability of holder who indorses two or more parts of a set to different persons.—Where the holder of a set indorses two or more parts to different persons he is liable on every such part, and every indorser subsequent to him is liable on the part he has himself indorsed, as if such parts were separate bills.

§313. Acceptance of bills drawn in sets.—The acceptance may be written on any part and it must be written on one part only. If the drawee accepts more than one part, and such accepted parts are negotiated to different holders in due course, he is liable on every such part as if it were a separate bill.

§314. Payment by acceptor of bills drawn in sets.—When the acceptor of a bill drawn in a set pays it without requiring the part bearing his acceptance to be delivered up to him, and that part at maturity is outstanding in the hands of a holder in due course, he is liable to the holder thereon.

§315. Effect of discharging one of a set.—Except as herein otherwise provided, where any one part of a bill drawn in a set is discharged by payment or otherwise the whole bill is discharged.

ARTICLE XVII.

PROMISSORY NOTES AND CHECKS.

§320. Promissory note defined.
§321. Check defined.
§322. Within what time a check must be presented.
§323. Certification of check; effect of.
§324. Effect where holder of check procures it to be certified.
§325. When check operates as an assignment.
§326. Recovery of forged check.

§320. Promissory note defined.—A negotiable promissory note within the meaning of this act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer. Where a note is drawn to the maker's own order, it is not complete until indorsed by him.

§321. Check defined.—A check is a bill of exchange drawn on a bank, payable on demand. Except as herein otherwise provided, the provisions of this act applicable to a bill of exchange payable on demand apply to a check.

§322. Within what time a check must be presented.—A check must be presented for payment within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay.

§323. Certification of check; effect of.—Where a check is certified by the bank on which it is drawn the certification is equivalent to an acceptance.

§324. Effect where the holder of check procures it to be certified.—Where the holder of a check procures it to be accepted or certified the drawer and all indorsers are discharged from liability thereon.

§325. When check operates as an assignment.—A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check.

§326. Recovery of forged check.—No bank shall be liable to a depositor for the payment by it of a forged or raised check, unless within one year after the return to the depositor of the voucher of such payment, such depositor shall notify the bank that the check so paid was forged or raised.

ARTICLE XVIII.

NOTES GIVEN FOR PATENT RIGHTS AND FOR A SPECULATIVE CONSIDERATION.

This Article appears only in New York and Ohio Acts

§330. Negotiable instruments given for patent rights.
§331. Negotiable instruments given for a speculative consideration.
§332. How negotiable bonds are made non-negotiable.

§330. Negotiable instruments given for patent rights.—A promissory note or other negotiable instrument, the consideration of which consists wholly or partly of the right to make, use or sell any invention claimed or represented by the vendor at the time of sale to be patented, must contain the words "given for a patent right" prominently and legibly written or printed on the face of such note or instrument above the signature thereto; and such note or instrument in the hands of any purchaser or holder is subject to the same defenses as in the hands of the original holder; but this section does not apply to a negotiable instrument given solely for the purchase price or the use of a patented article.

§331. Negotiable instruments for a speculative consideration.—If the consideration of a promissory note or other negotiable instrument consists in whole or in part of the purchase price of any farm product, at a price greater by at least four times than the fair market value of the same product at the time, in the locality, or of the membership and rights in an association, company or combination to produce or sell

any farm product at a fictitious rate, or of a contract or bond to purchase or sell any farm product at a price greater by four times than the market value of the same product at the time in the locality, the words, "given for a speculative consideration," or other words clearly showing the nature to the consideration, must be prominently and legibly written or printed on the face of such note or instrument above the signature thereof; and such note or instrument, in the hands of any purchaser or holder, is subject to the same defenses as in the hands of the original owner or holder.

§332. **How negotiable bonds are made non-negotiable.**—The owner or holder of any corporate or municipal bond or obligation (except such as are designated to circulate as money, payable to bearer) heretofore or hereafter issued and payable in this State, but not registered in pursuance of any State law, may make such bond or obligation, or the interest coupon accompanying the same, non-negotiable, by subscribing his name to a statement indorsed thereon that such bond, obligation or coupon is his property; and thereon the principal sum therein mentioned is payable only to such owner or holder, or his legal representatives or assigns, unless such bond, obligation or coupon be transferred by indorsement in blank, or payable to bearer, or to order, with the addition of the assignor's place of residence.

DIGEST OF THE FEDERAL BILL OF LADING ACT

Its Importance in Interstate and Foreign Commerce—Origin of Federal Bill of Lading Act

Considered second only in commercial importance to the Federal Reserve Act is the Federal Bill of Lading Act, otherwise known as the Pomerene Bill, which came into effect the first day of January, 1917. With its passage, bills of lading were transformed from simple contracts of shipment into important negotiable instruments, and the conditions under which they may be issued, are fully prescribed. Previous to that date, the bill of lading, which is the documentary evidence of the shipment of goods from producer to consumer, afforded no security of any kind to the banker who advanced money thereon.

For a long time prior to the passage of the Pomerene bill, a continued want was felt for legislation which would transform the bill of lading into a negotiable instrument, thereby rendering it capable

of being transferred in the same manner as a check or other commercial paper with its attendant advantages to the holder. The various commercial bodies of the country, principally, the Committee of the American Bankers Association, after an energetic campaign to bring about such legislation, were instrumental in having passed, by various States of the Union, from time to time, what is known as the "Uniform Bill of Lading Act", the purposes of which closely resemble the Pomerene bill. However, Acts known as the "Uniform Bill of Lading Act" enacted by the Legislatures of such States and adopted in whole or in part by some others, were found to be at variance with the requirements of a fundamentally sound document, and were far from uniform.

IMPORTANCE OF BILL OF LADING GREATLY INCREASED BY ACT

The Federal Bill of Lading Act, however, brought about a complete change in the bill of lading, which, as a receipt for goods delivered, represents ownership as well, and is the basis of acceptance in bills of exchange, both domestic and foreign.

IMPORTANT FEATURES OF THE FEDERAL BILL OF LADING ACT

The Federal Bill of Lading Act contains the following important features:

1. Provision is made for a uniform bill of lading.
2. Bills of lading are made easily and safely negotiable.
3. The burden of responsibility is shifted from the bank to the carrier.
4. Fraudulent practices in connection with bills of lading are made criminal and punishment provided therefor.

DIGEST OF THE FEDERAL BILL OF LADING ACT

A digest of this Act follows:

§1. Jurisdiction.—This Act exercises jurisdiction over bills of lading issued by any common carrier for the transportation of goods:

(a) Within any territory of the United States or the District of Columbia.

(b) From a State to a foreign country.
(c) From one State to another State.
(d) Between points in the same State through another State or through a foreign country.

§§2 and 3. Kinds of bills to be used.—

(a) Straight bill.
(b) Order bill.

A straight bill is one in which it is stated that the goods are consigned or destined to a specified person. Such bills are non-negotiable and must be so marked.

An order bill is one in which it is stated that the goods are consigned or destined to the order of any person named. Such bills are always negotiable. Any provision in an order bill to the effect that it is non-negotiable shall be void and shall not affect its negotiability unless made non-negotiable by the shipper in agreement in writing.

§4. Order bills not to be issued in part or sets.—Order bills may not be issued in parts or sets, except in the case of shipments to Alaska and Panama, and if so issued, the carrier will be held liable to anyone who purchases a part for value, in good faith, even though such purchase is made after delivery of the goods. The provisions contained in this Section, however, do not forbid the issuance of order bills in parts or sets for the transportation of goods to Alaska, Panama, Porto Rico, Philippines, Hawaii or other foreign countries.

§5. Duplicate necessary when more than one issued.—In the issuance of duplicate order bills for the transportation of goods to any place in the United States or on the continent of North America, except Alaska, and Panama, the word "duplicate" must be so marked plainly upon their face.

§6. Straight bill; how to be marked.—A straight bill shall have plainly upon its face by the carrier issuing it "non-negotiable" or "not negotiable."

§7. Effect of insertion of name of person to be notified.—The insertion of the name of a person to be notified of the arrival of the goods shall not limit the negotiability of order bills.

§8. **Carrier compelled to make delivery in absence of lawful excuse.**—A carrier in the absence of some lawful excuse, is bound to deliver goods upon a demand made by the consignee named in the bill for the goods (straight bill); or, if the bill is an order bill, by the holder thereof. In the latter case such a demand should be accompanied by:

(a) An offer to satisfy the carrier's lawful lien upon the goods.
(b) An offer to surrender the bill properly endorsed.
(c) A readiness and willingness to sign an acknowledgment for the delivery of the goods,

and in case of the carrier's refusal or failure to deliver the goods in compliance with the demand by the consignee or holder of the bill, the burden of establishing the existence of a lawful excuse shall be upon the carrier.

§9. **When carrier is justified in making delivery.**—A carrier is justified in making delivery to:

(a) One who is a person lawfully entitled to the possession of the goods.
(b) A consignee named in a straight bill.
(c) A person possessing an order bill stating that the goods are to be delivered to his order, or which has been indorsed to him or in blank by the consignee.

§10. **Liability of carrier when delivery made to person not entitled to goods.**—That where a carrier delivers goods to one who is not lawfully entitled to the possession of them, the carrier shall be liable to anyone having a right of property or possession in the goods if he delivered the goods otherwise than as authorized by subdivisions (b) and (c) of the preceding section; and, though he delivered the goods as authorized by either of said subdivisions, he shall be so liable if prior to such delivery he

(a) Had been requested, by or on behalf of a person having a right of property or possession in the goods, not to make such delivery, or
(b) Had information at the time of the delivery that it was to a person not lawfully entitled to the possession of the goods.

Such request or information, to be effective within the meaning of this section, must be given to an officer or agent, of the carrier, the

actual or apparent scope of whose duties includes action upon such a request or information, and must be given in time to enable the officer or agent to whom it is given, acting with reasonable diligence, to stop delivery of the goods.

§11. **Liability of carrier arising out of failure to cancel order bill.**—A carrier will be held liable if it fails to cancel an order bill on delivery, except when compelled by legal process, and if such bill is later acquired for value and in good faith.

§12. **Liability of carrier when making partial delivery.**—A carrier will be held liable in cases of partial delivery, except when compelled by legal process or failure to take up and cancel the bill or mark the bill with a description of the partial delivery, or if such bill is later acquired for value and in good faith.

§13. **Alterations, additions or erasures.**—Any bill which is in any way altered, added to or erased, without authority of the carrier, will be void.

§14. **When an order bill is lost, stolen or destroyed.**—When a bill is lost, stolen or destroyed, a Court of competent jurisdiction may order the delivery of the goods upon satisfactory proof of such loss upon the giving of an indemnifying bond. In such a case the carrier's costs and counsel fees must be paid. Liability of the carrier is not avoided in case such an order bill has been negotiated for value without notice of delivery.

§15. **Liability of carrier when bill marked "duplicate."**—A bill marked "duplicate" makes the carrier liable to the extent only of declaring that it is a true copy of the original.

§16. **When carrier is liable for non-delivery.**—The carrier will be liable for non-delivery when the title has not been transferred by the consignee to carrier or when the carrier has no lien on the goods.

§15. **When more than one claims title to goods.**—When one or more persons claim title to the goods, the carrier may require all known claimants to interplead either as a defense to an action for non-delivery or as an original suit.

§18. When carrier not liable for non-delivery of goods.—A carrier is not liable for the non-delivery of goods if he has knowledge of some person other than the consignee or holder of the bill, who has a claim, and will be excused from liability for refusing to deliver the goods until he has had a reasonable time to ascertain the validity of the adverse claim.

§19. Carrier not liable for any other circumstances in non-delivery.—Under no other circumstances than those noted in the preceding section, can a carrier be held liable for non-delivery.

§20. Liability for quantity and quality of shipment.—When goods are loaded by a carrier, it shall count the package freight and ascertain the kind and quantity of bulk freight. Insertions in the bill that it is the shipper's weight, load and count will be held to be void.

§21. Liability of carrier in loading.—When goods are loaded by the shipper and the bill states that it is the shipper's weight, load and count, the carrier must ascertain the kind and quantity of goods, and is not liable for the improper loading or the misdescription of goods in the bill of lading. In the case of a carrier having facilities at hand and the shipment being in bulk and requests being made in writing, the shipper's weight, load and count may be verified by the carrier's agent. The shipper's weight shall then not be inserted in the bill.

§22. Liability of carrier when bill is issued by authorized agent.—When a bill is issued by an agent of actual or apparent authority, the carrier is liable to the owner of the goods covered in a straight bill or to the bona fide holder for value of an order bill, although the goods are not received by the carrier or are misdirected.

§23. Rights of debtors and creditors.—While goods are in possession of a carrier, they may not be attached by garnishment or otherwise unless a bill is first surrendered to the carrier or its negotiation is enjoined.

§24. When creditor is entitled to aid of courts against debtor.—A creditor, whose debtor is the owner of an order bill, shall be entitled to the aids of Courts of jurisdiction in attaching such bill.

§25. When lien on goods for payment of freight arises.—When an order bill is issued, a carrier has a lien on the goods for all transportation and delivery charges.

§26. When carrier not liable for non-delivery.—A carrier will not be held liable for non-delivery after the goods have been lawfully sold to satisfy the carrier's lien, and when goods have not been claimed or when goods are perishable or hazardous.

§§27, 28, 29 and 30. Negotiation and transfer of bills.—A bill may be negotiated:

1. By the delivery to an indorsee of an order bill, the indorsement of an order bill in such case being required to be made by a person to whose order the goods are deliverable.
2. Such indorsement may be in blank or to a specified person and subsequent indorsements must be in like manner.
3. The transference of bills may be accompanied with an express or implied agreement to transfer the title to the bill or to the goods represented thereby. A straight bill, however, cannot be negotiated free from existing equities.
4. An order bill may be negotiated by any person possessing same, if the bill requires the carrier to deliver goods to the order of such person or is in such form that it may be negotiated by delivery.

§§31 and 32. Rights under transfer and negotiation.—These Sections regulate the rights of persons and parties under transfer and negotiation of bills. A person to whom a bill has been negotiated acquires thereby such a title to the goods as the person negotiating the bill had or the consignee and consignor had. A person to whom a bill has been transferred but not negotiated acquires as against the transferor the title to the goods, and if it is a straight bill, such person has a right to notify the carrier and becomes direct obligee of the carrier's obligations. A transfer of the bill may be defeated by garnishment proceedings by a creditor by prior notification of the carrier, the notification being required to be made to a proper agent of the carrier and within a reasonable time.

§33. Where order bill is transferred for value by delivery.—Where an order bill is transferred for value by delivery, the transferee acquires a right against a transferor to compel him to indorse the bill, when such is essential for negotiation.

§§34, 35 and 36. Liability of person who negotiates or transfers a bill.—A person negotiating or transferring bills by indorsement, warrants that the bill is genuine; that he has a legal right to transfer it; that he knows of no fact which might impair the validity or worth of the bill, and that he has a right to transfer the title to the goods. The indorser of the bill is not liable for the obligations of prior indorsers or the carrier. A mortgagee, pledgee or holder demanding payment of a debt does not thereby warrant the genuineness of such bill held as security, or quantity or quality of goods.

§§37, 38, 39 and 40. Rights of holders of bills.—The validity of title is not impaired when received in good fatih, for value, even though negotiation was a breach of duty, or in the case of the owner having been deprived of such bill by fraud, accident, mistake, duress, loss, theft or conversion.

Negotiation in the case of a person who has sold, mortgaged or pledged goods which are in the carrier's possession or who has sold, mortgaged, or pledged the order bill, but continued in possession of same, is not considered to have been effected from the first purchaser to the last holder. The rights of a purchaser of an order bill in good faith and for value, to whom such bill has been negotiated, shall not be defeated by the seller's lien or right of stoppage in transitu, whether such negotiation be prior or subsequent to notification to the carrier of the seller's claim. The carrier shall not be obliged to deliver goods to an unpaid seller unless the bill is first surrendered for cancellation. Except as above noted, no right of a mortgagee or lien holder is limited as against a purchaser of a bill for value and in good faith.

§41. Forgeries, etc.—Forgeries are to be adjudged misdemeanors punishable by imprisonment not exceeding five years or by fine not exceeding five thousand dollars or both, where a person with intent to defraud, falsely makes, alters, forges, counterfeits, prints or photographs any bill of lading or publishes as genuine any such forged bill or aids in its forging.

§42. Definitions.—Section 42 defines the following:

"Action" includes counterclaim, set off and suit in equity.
"Bill" means bill of lading governed by this Act.
"Consignee" means the person named in the bill as the person to whom delivery of the goods is to be made.

"Consignor" means the person named in the bill as the person from whom the goods have been received for shipment.
"Goods" means merchandise or chattels in course of transportation or which have been or are about to be transported.
"Holder of a bill" means a person who has both actual possession of such bill and a right to property therein.
"Order" means an order by indorsement on the bill.
"Person" includes a corporation or partnership or two or more persons having a joint or common interest.
"To purchase" includes to take as mortgagee and to take as pledgee.
"State" includes any territory, district, insular possession or isthmian possession.

§§43 and 44. Effectiveness of Act.—The provisions of this Act do not apply to bills made and delivered prior to the taking effect thereof, and such section and part of this Act is independent and severable, whereby one part, if declared void, does not invalidate the remainder of the Act.

§45. Takes effect January 1st, 1917.—This Section prescribes that this Act shall take effect on January 1st, 1917.

UNITED STATES WAREHOUSE ACT

The United States Warehouse Act and its Importance to the Bank Acceptance

The United States Warehouse Act is given here in full as a reference aid to the treatise on Acceptances. Since Bank Acceptances secured by warehouse receipts covering staple commodities, are one of the three eligible for rediscount, a study of the Act and the provisions which have greatly improved the financial standing of warehouse receipts, is recommended.

Features of the United States Warehouse Act

The new United States Warehouse Law, approved Aug. 11, 1916, provides for the issuance of licenses by the Secretary of Agriculture, for the operation of warehouses for the storage of agricultural products. The license brings the operation of the warehouse for which it is issued under an inspection service to be maintained by the Depart-

ment of Agriculture, and makes it incumbent for the licensee to give a bond in a sum fixed by the Secretary of Agriculture for the faithful discharge of his obligations to the owners of commodities placed in his custody. The inspection service includes an examination of the warehouse before the license is issued, and from time to time, to determine whether it is suitable for the purpose, and the practice and competency of the warehouseman in classifying according to grade and otherwise, weighing and certification of products, etc. The bond is a guaranty of faithful observance of State as well as Federal laws governing warehouse operations. An appropriation of $50,000 is made to defray the expenses of the Department of Agriculture in connection with this service for one year.

UNITED STATES WAREHOUSE ACT

§1. **Short title.**—That this Act shall be known by the short title of "United States Warehouse Act."

§2. **Definitions of terms used in Act.**—That the term "warehouse" as used in this Act shall be deemed to mean every building, structure, or other protected inclosure in which any agricultural product is or may be stored for interstate or foreign commerce, or, if located within any place under the exclusive jurisdiction of the United States, in which any agricultural product is or may be stored. The term "agricultural product" wherever used in this Act shall be deemed to mean cotton, wool, grains, tobacco, and flaxseed, or any of them. As used in this Act, "person" includes a corporation or partnership or two or more persons having a joint or common interest; "warehouseman" means a person lawfully engaged in the business of storing agricultural products; and "receipt" means a warehouse receipt.

§3. **Powers of Secretary of Agriculture under Act.**—That the Secretary of Agriculture is authorized to investigate the storage, warehousing, classifying according to grade and otherwise, weighing, and certification of agricultural products; upon application to him by any person applying for license to conduct a warehouse under this Act, to inspect such warehouse or cause it to be inspected; at any time, with or without application to him, to inspect or cause to be inspected all warehouses licensed under this Act; to determine whether warehouses for which licenses are applied for or have been issued under

this Act are suitable for the proper storage of any agricultural product or products; to classify warehouses licensed or applying for a license in accordance with their ownership, location, surroundings, capacity, conditions, and other qualities, and as to the kinds of licenses issued or that may be issued for them pursuant to this Act; and to prescribe, within the limitations of this Act, the duties of the warehousemen conducting warehouses licensed under this Act with respect to their care of and responsibility for agricultural products stored therein.

§4. Issuance of license by the Secretary of Agriculture.—That the Secretary of Agriculture is authorized, upon application to him, to issue to any warehouseman a license for the conduct of a warehouse or warehouses in accordance with this Act and such rules and regulations as may be made hereunder; PROVIDED, That each such warehouse be found suitable for the proper storage of the particular agricultural product or products for which a license is applied for, and that such warehouseman agree, as a condition to the granting of the license, to comply with and abide by all the terms of this Act and the rules and regulations prescribed hereunder.

§5. Period of issuance of license.—That each license issued under sections four and nine of this Act shall be issued for a period not exceeding one year and shall specify the date upon which it is to terminate, and upon showing satisfactory to the Secretary of Agriculture, may from time to time be renewed or extended by a written instrument, which shall specify the date of its termination.

§6. Warehouseman required to file bond to secure faithful performance of his obligations.—That each warehouseman applying for a license to conduct a warehouse in accordance with this Act, shall, as a condition to the granting thereof, execute and file with the Secretary of Agriculture a good and sufficient bond other than personal security to the United States to secure the faithful performance of his obligations as a warehouseman under the laws of the State, District, or Territory in which he is conducting such warehouse, as well as under the terms of this Act and the rules and regulations prescribed hereunder, and of such additional obligations as a warehouseman as may be assumed by him under contracts with the respective depositors of agricultural products in such warehouse. Said bond shall be in such form and amount, shall have such surety or sureties, subject to service

of process in suits on the bond within the State, District, or Territory in which the warehouse is located, and shall contain such terms and conditions as the Secretary of Agriculture may prescribe to carry out the purposes of this Act, including the requirements of fire insurance. Whenever the Secretary of Agriculture shall determine that a bond approved by him is, or for any cause has become, insufficient, he may require an additional bond or bonds to be given by the warehouseman concerned, conforming with the requirements of this section, and unless the same be given within the time fixed by a written demand therefor, the license of such warehouseman may be suspended or revoked.

§7. Person injured by breach of any obligation may sue on the bond.—That any person injured by the breach of any obligation to secure which a bond is given, under the provisions of sections six or nine, shall be entitled to sue on the bond in his own name in any court of competent jurisdiction to recover the damages he may have sustained by such breach.

§8. When warehouse is bonded.—That upon the filing with and approval by the Secretary of Agriculture of a bond, in compliance with this Act, for the conduct of a warehouse, such warehouse shall be designated as bonded hereunder; but no warehouse shall be designated as bonded under this Act, and no name or description conveying the impression that it is so bonded, shall be used, until a bond, such as provided for in section six, has been filed with and approved by the Secretary of Agriculture, nor unless the license issued under this Act for the conduct of such warehouse remains unsuspended and unrevoked.

§9. When license may be issued to person not warehouseman.—That the Secretary of Agriculture may, under such rules and regulations as he shall prescribe, issue a license to any person not a warehouseman to accept the custody of agricultural products and to store the same in a warehouse or warehouses owned, operated, or leased by any State, upon condition that such person agree to comply with and abide by the terms of this Act and the rules and regulations prescribed hereunder. Each person so licensed shall issue receipts for the agricultural products placed in his custody, and shall give bond, in accordance with the provisions of this Act and the rules and regulations here-

under affecting warehousemen licensed under this Act, and shall otherwise be subject to this Act and such rules and regulations to the same extent as is provided for warehousemen licensed hereunder.

§10. Reasonable fees to be charged by Secretary of Agriculture.—That the Secretary of Agriculture shall charge, assess, and cause to be collected a reasonable fee for every examination or inspection of a warehouse under this Act when such examination or inspection is made upon application of a warehouseman, and a fee not exceeding $2 per annum for each license or renewal thereof issued to a warehouseman under this Act. All such fees shall be deposited and covered into the Treasury as miscellaneous receipts.

§11. When person may be licensed for what purposes.—That the Secretary of Agriculture may, upon presentation of satisfactory proof of competency, issue to any person a license to classify any agricultural product or products, stored or to be stored in a warehouse licensed under this Act, according to grade or otherwise and to certificate the grade or other class thereof, or to weigh the same and certificate the weight thereof, or both to classify and weigh the same and to certificate the grade or other class and the weight thereof, upon condition that such person agree to comply with and abide by the terms of this Act and of the rules and regulations prescribed hereunder so far as the same relate to him.

§12. May suspend such license if person misapplies authority.—That any license issued to any person to classify or to weigh any agricultural product or products under this Act may be suspended or revoked by the Secretary of Agriculture whenever he is satisfied, after opportunity afforded to the licensee concerned for a hearing, that such licensee has failed to classify or to weigh any agricultural product or products correctly, or has violated any of the provisions of this Act or of the rules and regulations prescribed hereunder, so far as the same may relate to him, or that he has used his license or allowed it to be used for any improper purpose whatsoever. Pending investigation, the Secretary of Agriculture, whenever he deems necessary, may suspend a license temporarily without hearing.

§13. Receipt of products for storage.—That every warehouseman conducting a warehouse licensed under this Act shall receive for stor-

age therein, so far as its capacity permits, any agricultural product of the kind customarily stored therein by him which may be tendered to him in a suitable condition for warehousing, in the usual manner in the ordinary and usual course of business, without making any discrimination between persons desiring to avail themselves of warehouse facilities.

§14. Person depositing does so under terms of this Act.—That any person who deposits agricultural products for storage in a warehouse licensed under this Act shall be deemed to have deposited the same subject to the terms of this Act and the rules and regulations prescribed hereunder.

§15. Inspecting and grading of grains, flaxseed, etc.—That grain, flaxseed, or any other fungible agricultural product stored for interstate or foreign commerce, or in any place under the exclusive jurisdiction of the United States, in a warehouse licensed under this Act shall be inspected and graded by a person duly licensed to grade the same under this Act.

§16. Segregation of stored products to permit identification, etc.—That every warehouseman conducting a warehouse licensed under this Act shall keep the agricultural products therein of one depositor so far separate from agricultural products of other depositors, and from other agricultural products of the same depositor for which a separate receipt has been issued, as to permit at all times the identification and redelivery of the agricultural products deposited; but if authorized by agreement or by custom, a warehouseman may mingle fungible agricultural products with other agricultural products of the same kind and grade, and shall be severally liable to each depositor for the care and redelivery of his share of such mass, to the same extent and under the same circumstances as if the agricultural products had been kept separate, but he shall at no time, while they are in his custody mix fungible agricultural products of different grades.

§17. Warehouseman required to issue receipts for products stored.—That for all agricultural products stored for interstate or foreign commerce, or in any place under the exclusive jurisdiction of the United States, in a warehouse licensed under this Act, original receipts shall be issued by the warehouseman conducting the same, but no receipts

shall be issued except for agricultural products actually stored in the warehouse at the time of the issuance thereof.

§18. **What receipt should embody.**—That every receipt issued for agricultural products stored in a warehouse licensed under this Act shall embody within its written or printed terms (a) the location of the warehouse in which the agricultural products are stored; (b) the date of issue of the receipt; (c) the consecutive number of the receipt; (d) a statement whether the agricultural products received will be delivered to the bearer, to a specified person, or to a specified person or his order; (e) the rate of storage charges; (f) a description of the agricultural products received, showing the quantity thereof, or, in case of agricultural products customarily put up in bales or packages, a description of such bales or packages by marks, numbers, or other means of identification and the weight of such bales or packages; (g) the grade or other class of the agricultural products received and the standard or description in accordance with which such classification has been made: PROVIDED, That such grade or other class shall be stated according to the official standard of the United States applicable to such agricultural products as the same may be fixed and promulgated under authority of law: PROVIDED FURTHER, That until such official standards of the United States for any agricultural product or products have been fixed and promulgated, the grade or other class thereof may be stated in accordance with any recognized standard or in accordance with such rules and regulations not inconsistent herewith as may be prescribed by the Secretary of Agriculture; (h) a statement that the receipt is issued subject to the United States Warehouse Act and the rules and regulations prescribed thereunder; (i) if the receipt be issued for agricultural products of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership; (j) a statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien: PROVIDED, That if the precise amount of such advances made or of such liabilities incurred be at the time of the issue of the receipt unknown to the warehouseman or his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof shall be sufficient; (k) such other terms and conditions within the limitations of this Act as may be required by the Secretary of Agriculture; and (l) the signature of the warehouseman, which may be made by his authoried agent: PRO-

VIDED, That unless otherwise required by the law of the State in which the warehouse is located, when requested by the depositor of other than fungible agricultural products, a receipt omitting compliance with subdivision (g) of this section may be issued if it have plainly and conspicuously embodied in its written or printed terms a provision that such receipt is not negotiable.

§19. Secretary of Agriculture to promulgate standards.—That the Secretary of Agriculture is authorized, from time to time, to establish and promulgate standards for agricultural products in this Act defined by which their quality or value may be judged or determined: PROVIDED, That the standards for any agricultural products which have been, or which in future may be, established by or under authority of any other Act of Congress shall be, and are hereby, adopted for the purposes of this Act as the official standards of the United States for the agricultural products to which they relate.

§20. While an original receipt is outstanding no further receipt shall be issued.—That while an original receipt issued under this Act is outstanding and uncanceled by the warehouseman issuing the same no other or further receipt shall be issued for the agricultural product covered thereby or for any part thereof, except that in the case of a lost or destroyed receipt, a new receipt, upon the same terms and subject to the same conditions and bearing on its face the number and date of the receipt in lieu of which it is issued, may be issued upon the compliance with the statutes of the United States applicable thereto in places under the exclusive jurisdiction of the United States or upon compliance with the laws of any State applicable thereto in any place not under the exclusive jurisdiction of the United States: PROVIDED, That if there be in such case no statute of the United States or law of a State applicable thereto such new receipts may be issued upon the giving of satisfactory security in compliance with the rules and regulations made pursuant to this Act.

§21. Delivery.—That a warehouseman conducting a warehouse licensed under this Act, in the absence of some lawful excuse, shall, without unnecessary delay, deliver the agricultural products stored therein upon a demand made either by the holder of a receipt for such agricultural products or by the depositor thereof if such demand be accompanied with (a) an offer to satisfy the warehouseman's lien;

(b) an offer to surrender the receipt, if negotiable, with such indorsements as would be necessary for the negotiation of the receipt; and (c) a readiness and willingness to sign, when the products are delivered, an acknowledgment that they have been delivered if such signature is requested by the warehouseman.

§22. Warehouseman shall cancel each receipt returned.—That a warehouseman conducting a warehouse licensed under this Act shall plainly cancel upon the face thereof each receipt returned to him upon the delivery by him of the agricultural products for which the receipt was issued.

§23. Warehouseman required to keep records and make reports.—That every warehouseman conducting a warehouse licensed under this Act shall keep in a place of safety complete and correct records of all agricultural products stored therein and withdrawn therefrom, of all warehouse receipts issued by him, and of the receipts returned to and canceled by him, shall make reports to the Secretary of Agriculture concerning such warehouse and the condition, contents, operation, and business thereof in such form and at such times as he may require, and shall conduct said warehouse in all other respects in compliance with this Act and the rules and regulations made hereunder.

§24. Business regulated by Secretary of Agriculture.—That the Secretary of Agriculture is authorized to cause examinations to be made of any agricultural product stored in any warehouse licensed under this Act. Whenever, after opportunity for hearing is given to the warehouseman conducting such warehouse, it is determined that he is not performing fully the duties imposed on him by this Act and the rules and regulations made hereunder, the Secretary may publish his findings.

§25. Revocation of license after hearing and suspension.—That the Secretary of Agriculture may, after opportunity for hearing has been afforded to the licensee concerned, suspend or revoke any license issued to any warehouseman conducting a warehouse under this Act, for any violation of or failure to comply with any provision of this Act or of the rules and regulations made hereunder or upon the ground that unreasonable or exorbitant charges have been made for services rendered. Pending investigation, the Secretary of Agriculture, whenever he deems necessary, may suspend a license temporarily without hearing.

§26. Publication of results of investigation.—That the Secretary of Agriculture from time to time may publish the results of any investigations made under section three of this Act; and he shall publish the names and locations of warehouses licensed and bonded and the names and addresses of persons licensed under this Act and lists of all licenses terminated under this Act and the causes therefor.

§27. Examination of books, records, etc.—That the Secretary of Agriculture is authorized through officials, employees or agents of the Department of Agriculture designated by him to examine all books, records, papers, and accounts of warehouses licensed under this Act and of the warehousemen conducting such warehouses relating thereto.

§28. Make rules and regulations necessary.—That the Secretary of Agriculture shall from time to time make such rules and regulations as he may deem necessary for the efficient execution of the provisions of this Act.

§29. This act not to be construed to conflict with, impair or limit State laws.—That nothing in this Act shall be construed to conflict with, or to authorize any conflict with, or in any way to impair or limit the effect or operation of the laws of any State relating to warehouses, warehousemen, weighers, graders, or classifiers; but the Secretary of Agriculture is authorized to cooperate with such officials as are charged with the enforcement of such State laws in such States and through such cooperation to secure the enforcement of the provisions of this Act; nor shall this Act be construed so as to limit the operation of any statute of the United States relating to warehouses or warehousemen, weighers, graders, or classifiers now in force in the District of Columbia or in any Territory or other place under the exclusive jurisdiction of the United States.

§30. Punishment provided for misdemeanors.—That every person who shall forge, alter, counterfeit, simulate, or falsely represent, or shall without proper authority use, any license issued by the Secretary of Agriculture under this Act, or who shall violate or fail to comply with any provision of section eight of this Act, or who shall issue or utter a false or fraudulent receipt or certificate, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall be

fined not more than $500 or imprisoned not more than six months, or both, in the discretion of the court.

§31. **Appropriation.**—That there is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of $50,000, available until expended, for the expenses of carrying into effect the provisions of this Act, including the payment of such rent and the employment of such persons and means as the Secretary of Agriculture may deem necessary in the City of Washington and elsewhere, and he is authorized, in his discretion, to employ qualified persons not regularly in the service of the United States for temporary assistance in carrying out the purposes of this Act, and out of the moneys appropriated by this Act to pay the salaries and expenses thereof.

§32. **Effect of invalidity of part of Act.**—That if any clause, sentence, paragraph, or part of this Act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder thereof, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

§33. That the right to amend, alter, or repeal this Act is hereby expressly reserved.

STAMP TAXES

TAXATION OF CHECKS, ACCEPTANCES, DRAFTS AND PROMISSORY NOTES

Taxation of Negotiable Instruments; Checks, Drafts, Promissory Notes, and Acceptances

Trade and Bank Acceptances, being in the same class as other negotiable instruments, are subject to the same laws pertaining to stamp taxes as are checks, drafts and promissory notes.

Classes of Negotiable Instruments Taxable

By the Federal Revenue Act of 1918, in effect April 1, 1919, there is imposed a tax on such negotiable instruments as above mentioned,

payable otherwise than at sight or on demand, upon their acceptance or delivery within the United States, whichever is prior, and on promissory notes, except those given below as exempt, and on each renewal of the same,—2 cents on each $100. or fractional part thereof. Amounts not exceeding $100. are taxable to the extent of 2 cents. The "United States" as given in this law, includes the District of Columbia, Hawaii and Alaska.

Text of Law

The text of the law as relates to such taxation follows:—

Drafts or checks (payable otherwise than at sight or on demand), upon their acceptance or delivery within the United States, whichever is prior, promissory notes, except bank notes issued for circulation, and for each renewal of the same, for an amount not exceeding $100. are taxed 2 cents, and for each additional $100. or fractional part thereof, 2 cents.

Analysis of Negotiable Instruments taxable

Included amongst the taxable instruments payable otherwise than at sight or on demand are the following:

1. Trade Acceptances.
2. Bankers' Acceptances.
3. Time drafts which are drawn on a domestic bank to secure money to be used in purchasing goods for exportation.
4. Time drafts which are drawn against the proceeds of time drafts directly covering exports to a foreign country, and which constitute an inherent, necessary and bona fide part of the actual process of exportation.
5. Drafts which state no time for payment, but which are accepted payable on a certain future date.
6. Time drafts which cover articles shipped from the United States, Alaska and Hawaii to the Canal Zone, if such drafts are delivered within the United States, Alaska or Hawaii.
7. Time drafts which do not cover exports, drawn and delivered or accepted in the United States and payable in foreign countries.
8. Post-dated checks which are expressly payable after their date.
9. Time drafts which are drawn against shipments from the Philippines, Virgin Islands, and Porto Rico into the United States, if delivery or acceptance of such drafts first takes place within the United States, Hawaii or Alaska.

When and where Negotiable Instruments Exempt from Taxation

The following checks and drafts are exempt from taxation under this law:

1. All checks and drafts drawn on demand.
2. Post-dated checks which are not expressly payable after their date.
3. Drafts which are drawn abroad on a foreign drawee with a foreign payee and pass through a bank in the United States in the course of collection, unless delivered by an agent of the drawer to an agent of the payee within the United States.
4. Time drafts which are drawn on domestic banks against export shipments delivered to the first carrier for transportation, covering the period of transit from the interior point to the seaboard.
5. Time drafts which cover shipments to the Philippines, the Virgin Islands and Porto Rico.
6. Time drafts which directly cover exports to a foreign country, and constitute an inherent, necessary and bona fide part of the actual process of exportation.

Promissory Notes Included; When and Where Taxable

Promissory notes as outlined in the following, and renewals of same, are also negotiable instruments upon which a tax is imposed:

1. Notes which are given for security only.
2. Notes which are payable on demand or after date.
3. Promissory notes which are secured by bonds of the War Finance Corporation.
4. Promissory notes which accompany mortgages of joint-stock land banks.
5. Instruments which are in the form of promissory notes, representing the interest upon promissory notes, not included in (5) below, and either separate from or prepared in a form and for the purpose of being separated from the principal note.
6. Promissory notes which are executed and mailed in the United States to a payee in Canada.
7. Extensions or renewals of promissory notes which are brought about by extensions of mortgages by which such notes are secured.
8. Policy loan and premium extension agreements which contain an unqualified promise to pay a specified sum of money

at a certain date, excepting where the only remedy of the payee is to reduce or cancel the rights of the insured in case of non-payment of the premiums or loans.

Promissory Notes; when and where exempt from Taxation

The following promissory notes are exempt from taxation:

1. Certificates of deposit.
2. Bank notes which are issued for circulation.
3. Promissory notes which are issued directly by foreign governments and which are placed in this country for sale.
4. Promissory notes which are executed and mailed in Canada to a payee within the United States.
5. Coupons attached to a principal obligation which are substantially repetitions of the promise to pay interest contained in the principal obligation.
6. Promissory notes which are secured by certificates of indebtedness issued by the Director General of Railroads.
7. Promissory notes which are secured by United States bonds or obligations issued after April 24, 1917, or secured by the pledge of a promissory note which itself is secured by the pledge of such bonds or obligations. Such bonds must have a par value of not less than the amount of such notes to exempt the latter.

Government and Municipal Obligations Exempted

Instruments exempt.—There shall not be taxed under this title any bond, note or other instrument, issued by the United States, or by any foreign Government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power.

Penalty for failure to comply.—Whoever makes, signs, issues or accepts, or causes to be made, signed, issued or accepted, any instrument, document, or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid;

Makes use of any adhesive stamp to denote any tax imposed by this title without canceling or obliterating such stamp as prescribed below;

Is guilty of a misdemeanor and upon conviction thereof shall pay a fine of not more than $100. for each offense.

Whoever fraudulently cuts, tears, or removes from any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, any adhesive stamp or the impression of any stamp, die, plate or other article provided, made, or used in pursuance of this title;

Fraudulently uses, joins, fixes, or places to, with, or upon any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, (1) any adhesive stamp, or the impression of any stamp, die, plate, or other article, which has been cut, torn or removed from any other vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title; or (2) any adhesive stamp or the impression of any stamp, die, plate, or other article of insufficient value; or (3) any forged or counterfeit stamp, or the impression of any forged or counterfeit stamp, die, plate or other article;

Wilfully removes, or alters the cancellation, or defacing marks of, or otherwise prepares, any adhesive stamp, with intent to use, or cause the same to be used, after it has been already used, or knowingly or wilfully buys, sells, offers for sale, or gives away, any such washed or restored stamp to any person for use, or knowingly uses the same;

Knowingly and without lawful excuse (the burden of proof of such excuse being on the accused) has in possession any washed, restored, or altered stamp, which has been removed from any vellum, parchment, paper, instrument, writing, package, or article;

Is guilty of a misdemeanor, and upon conviction shall be punished by a fine of not more than $1,000. or by imprisonment for not more than five years, or both, and any such reused, canceled, or counterfeit stamp and the vellum, parchment, document, paper, package, or article upon which it is placed or impressed shall be forfeited to the United States.

Cancellation.—That whenever an adhesive stamp is used for denoting any tax imposed by this title, except as hereinafter provided, the person using or affixing the same shall write or stamp or cause to be written or stamped thereupon the initials of his or her name and the date upon which the same is attached or used, so that the same may not again be used: PROVIDED, That the Commissioner may prescribe such other method for the cancellation of such stamps as he may deem expedient.

Cancellation may be effected also with a machine or punch, but must

not so deface the stamp as to prevent its denomination and genuiness from being readily determined.

Use of cancelled stamps—refunds.—A stamp once having been affixed to an instrument and cancelled cannot lawfully be removed and attached to another instrument. Refund will be made by the collector of internal revenue for amounts paid for stamps used in excess of requirements, or on instruments not actually effective and for which a substitute is prepared and stamped, or on instruments not subject to tax.

Liability to tax.—The liability to tax and the amount thereof, is determined by the form and face of a check or draft and cannot be affected by proof of facts or circumstances outside of the instrument. Payment for the stamp is a matter for adjustment between the parties, but the obligation rests upon the drawee, payee, or indorsee of a draft to see that the tax is paid before or at the time of acceptance or delivery, and both parties to a promissory note are responsible for affixing and cancelling stamps in the required amount.

FOREIGN FINANCING

UNDER

THE EDGE ACT

LAWS AND SYNOPSIS

FOREIGN FINANCING UNDER THE EDGE ACT

Since the termination of the great war, our international commerce, which had been built up at a tremendous cost, has been threatened by new conditions seriously affecting its progress.

The danger confronting the United States in its foreign trade may be attributed to the following reasons: During the past year, a very serious situation has arisen in connection with the exchange rates on foreign countries. The pound sterling, the mark, the franc, the lire, and other European currencies have declined in value considerably, correspondingly raising the value of the American dollar in foreign countries. This has made it almost impossible for Europeans to buy American goods.

A more serious problem has presented itself in connection with the credit requirements of European nations,—long terms credits,—which the American exporter and banker have found it very difficult to extend.

Prior to the adoption of the Federal Reserve System in the United States, the greater part of our foreign trade was carried on by the larger English banking houses and by some strong and internationally established private banking establishments in New York and in England, which had foreign branches throughout the world. The smaller institutions of the country could extend assistance to the American foreign trade merchant only to a very limited extent.

As far back as 1913, steps were taken to procure for the merchant of this country a larger participation in foreign trade and commerce. The Federal Reserve Act provided, among other things, that any national banking association having a capital and surplus of at least one million dollars, might, upon securing the approval of the Federal Reserve Board, establish branches in foreign countries and dependencies of the United States.

In 1916, an Amendment was passed to the Federal Reserve Act permitting national banks having a capital and surplus of at least one million dollars to cooperate in the establishment or ownership of American banks or corporations principally engaged in foreign banking, by investing to an amount not to exceed ten percentum of their

capital and surplus in such institutions "chartered or incorporated under the laws of the United States or of any State thereof."

Under the Amendment to the Federal Reserve Act, so passed, certain banking institutions were instrumental in organizing banking corporations of the kind contemplated by the Amendment, mainly for the purpose of financing American exporters and importers.

However, they could extend their help only to a limited degree and frequent appeals were made for Federal incorporation, which, it was believed, would greatly lower the risk in putting out capital in foreign branches. As a consequence, new legislation was called for. The national banks of the country, moreover, felt the need of Federal legislation which would entitle them to the benefits and protection of a Federal charter, enabling them to compete for business in foreign countries upon a larger and more profitable scale.

On September 17, 1919, the McLean Bill became a law, under the provisions of which, national banks, without regard to the amount of their capital and surplus, are permitted to subscribe in amounts not in excess of five percentum of their capital and surplus, to the capital of corporations of the kind contemplated by the Edge Act, thus enabling national banks to further contribute to the financing of our foreign trade.

The Edge Act had its introduction into the United States Senate on July 15th, 1919, and became a law on December 24th, of that year. By the passage of the Edge Act, supplementing the Amendments to the Federal Reserve Act and the McLean Act, providing for participation by national banks in the organization of corporations principally engaged in foreign banking and financing, it is hoped that much of our great foreign trade can be retained to the benefit of American manufacturers and producers.

The Act provides for the Federal incorporation and regulation of banking institutions for the purpose of engaging in foreign banking or other foreign financial operations or for engaging in such operations in a dependency or insular possession of the United States, either directly or through the agency, ownership or control of local institutions in such places.

Briefly described, the Act distinguishes between two classes of corporations—one class doing principally a banking business, the other an investment business, taking long time paper, including bonds and mortgages and issuing their own debentures against them.

As to the first class, those corporations carrying on a banking busi-

ness may conduct every nature of financial operation with the exception of receiving deposits in the United States, except such as may be incidental to or for the purpose of carrying out transactions abroad.

Both classes of corporations are prohibited from carrying on any part of their business activities in the United States, except such as, in the opinion of the Federal Reserve Board, may be incidental to their foreign or international business.

They may not become members of the Federal Reserve System and are not authorized to invest in any corporation other than a banking corporation an amount in excess of ten percentum of their own capital and surplus without the approval of the Federal Reserve Board.

The procedure contemplated under the Edge Act for foreign financing, is one by which a party sells merchandise to a second party who is penniless and yet obtains actual money in the transaction. The American exporter or manufacturer may sell his goods to an impoverished foreign purchaser—a foreign government or a private concern.

Corporations organized under the Edge Act may accept collateral from the purchaser such as is acceptable to the Federal Reserve Board, and against this may issue debentures to be sold to investors, the proceeds of which sale will be paid to the American seller.

The Act is very extensive in its operations, and powers are granted to these corporations permitting them to accept even mortgages on the plants or other real property of the purchasers.

A foreign concern in need of raw material may obtain it by giving a mortgage on its plant, and eventually, by turning this raw material into finished products, will be enabled to redeem its collateral and to put aside a little profit besides.

While it is true that some of the leading banking institutions of the country have rendered a noticeable service to the commerce of the nation in the form of short term credits, their liabilities are, however, limited. Long term credits, that is, for periods beyond ninety days, are made possible by the Edge Act. For example, a corporation located in Belgium is desirous of purchasing American machinery for the rebuilding of its factories. The transaction called for is on the basis of "credit extension" to the Belgium firm, which may have given, as security for the purchase price, corporate bonds maturing eight or ten years hence. Even though this security is acceptable as regards safety to the American manufacturer, he is still unable to extend such long term credit and is unable to carry the bonds until maturity, because this would result in a tie-up of his capital. The seller, there-

fore, would be compelled to lose the sale unless the bonds can be quickly converted into cash.

The Edge Act for foreign financing would come in as of direct assistance. The American manufacturer could then arrange with a corporation organized under the Act to take such foreign securities, advance the cash, and within such limitations as the law and the Federal Reserve Board prescribe, issue its own notes, which could then be offered to the public for investment. The result of this roundabout financing is that the purchaser at once receives the purchase price and the European buyer the goods. The credit is passed to the American investor.

The Edge Act, therefore, provides for the organization of corporations given the right to engage in international and foreign banking, and in which national banks may participate to a limited extent, thereby affording a means of making available quick and large capital for the purpose of extending credit to Europe.

It provides for a well regulated system of financing our foreign trade, whereby such collateral as foreign purchasers possess may be taken in payment of American goods. While it is true that State institutions have been important factors in the financing of American foreign trade until the present, still the corporations which may be organized under the Edge Act will come as an additional inducement offering the assistance of the American investor and banker on a much wider scale than heretofore possible.

Following is given the text and of the Edge Act in relation to foreign financing, which became a law on December 24, 1919.

THE EDGE ACT

For Foreign Financing

Approved December 24, 1919

AN ACT

To amend the Act approved December 23, 1913, known as the Federal Reserve Act

BE it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Act approved December 23, 1913, known as the Federal Reserve Act, as amended, be further amended by adding a new section as follows:

"BANKING CORPORATIONS AUTHORIZED TO DO FOREIGN BANKING BUSINESS

Organization of Corporations

"Sec. 25 (a). Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions as provided by this section, and to act when required by the Secretary of the Treasury as fiscal agents of the United States, may be formed by any number of natural persons, not less in any case than five.

Articles of association.—"Such persons shall enter into articles of association which shall specify in general terms the objects for which the association is formed and may contain any other provisions not inconsistent with law which the association may see fit to adopt for the regulation of its business and the conduct of its affairs.

Required to be forwarded to Federal Reserve Board.—"Such articles of association shall be signed by all of the persons intending to participate in the organization of the corporation and, thereafter, shall be forwarded to the Federal Reserve Board and shall be filed and preserved in its office. The persons signing the said articles of association shall, under their hands, make an organization certificate which shall specifically state:

What is required to be stated.—"First. The name assumed by such corporation, which shall be subject to the approval of the Federal Reserve Board.

"Second. The place or places where its operations are to be carried on.

"Third. The place in the United States where its home office is to be located.

"Fourth. The amount of its capital stock and the number of shares into which the same shall be divided.

"Fifth. The names and places of business or residence of the persons executing the certificate and the number of shares to which each has subscribed.

"Sixth. The fact that the certificate is made to enable the persons subscribing the same, and all other persons, firms, companies, and corporations, who or which may thereafter subscribe to or purchase shares of the capital stock of such corporation, to avail themselves of the advantages of this section.

CORPORATE FUNCTIONS

Organization formalities; directors must be citizens.—"The persons signing the organization certificate shall duly acknowledge the execution thereof before a judge of some court of record or notary public, who shall certify thereto under the seal of such court or notary, and thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed and preserved in its office. Upon duly making and filing articles of association and an organization certificate, and after the Federal Reserve Board has approved the same and issued a permit to begin business, the association shall become and be a body corporate, and as such and in the name designated therein shall have power to adopt and use a corporate seal, which may be changed at the pleasure of its board of directors; to have succession for a period

of twenty years unless sooner dissolved by the act of the shareholders owning two-thirds of the stock or by an Act of Congress or unless its franchises become forfeited by some violation of law; to make contracts; to sue and be sued, complain, and defend in any court of law or equity; to elect or appoint directors, all of whom shall be citizens of the United States; and, by its board of directors, to appoint such officers and employees as may be deemed proper, define their authority and duties, require bonds of them, and fix the penalty thereof, dismiss such officers or employees, or any thereof, at pleasure and appoint others to fill their places; to prescribe, by its board of directors, by-laws not inconsistent with law or with the regulations of the Federal Reserve Board regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers and employees appointed, its property transferred, and the privileges granted to it by law exercised and enjoyed.

GENERAL POWERS

Foreign exchange operations; debentures to ten times capital stock and surplus; limitations on deposits; reserve board oversight; reserve against deposits.—"Each corporation so organized shall have power, under such rules and regulations as the Federal Reserve Board may prescribe:

"(a) To purchase, sell, discount, and negotiate, with or without its indorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness; to purchase and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided; to accept bills or drafts drawn upon it subject to such limitations and restrictions as the Federal Reserve Board may impose; to issue letters of credit; to purchase and sell coin, bullion, and exchange; to borrow and to lend money; to issue debentures, bonds, and promissory notes under such general conditions as to security and such limitations as the Federal Reserve Board may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times its capital stock and surplus; to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to or for the purpose of carrying out transactions in

foreign countries or dependencies or insular possessions of the United States; and generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Federal Reserve Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein. Nothing contained in this section shall be construed to prohibit the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the corporation and outstanding at any one time. Whenever a corporation organized under this section receives deposits in the United States authorized by this section it shall carry reserves in such amounts as the Federal Reserve Board may prescribe, but in no event less than 10 per centum of its deposits.

Establishment of agencies and branches.—"(b) To establish and maintain for the transaction of its business branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Federal Reserve Board and under such rules and regulations as it may prescribe, including countries or dependencies not specified in the original organization certificate.

POWER TO PURCHASE AND HOLD STOCK

Stock of other corporations; limit to holding.—"(c) With the consent of the Federal Reserve Board to purchase and hold stock or other certificates of ownership in any other corporation organized under the provisions of this section, or under the laws of any foreign country or a colony or dependency thereof, or under the laws of any State, dependency or insular possession of the United States but not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States and not transacting any business in the United States except such as in the judgment of the Federal Reserve Board may be incidental to its international or foreign business: PROVIDED, HOWEVER, That, except with the approval of the Federal Reserve Board, no corporation organized hereunder shall invest in any one corporation an amount in excess of 10 per centum of its own capital and surplus, except in a corporation engaged in the business

of banking, when 15 per centum of its capital and surplus may be so invested: PROVIDED FURTHER, That no corporation organized hereunder shall purchase, own, or hold stock or certificates of ownership in any other corporation organized hereunder or under the laws of any State which is in substantial competition therewith, or which holds stock or certificates or ownership in corporations which are in substantial competition with the purchasing corporation.

Purchase to prevent loss.—"Nothing contained herein shall prevent corporations organized hereunder from purchasing and holding stock in any corporation where such purchase shall be necessary to prevent a loss upon a debt previously contracted in good faith; and stock so purchased or acquired in corporations organized under this section shall within six months from such purchase be sold or disposed of at public or private sale unless the time to so dispose of same is extended by the Federal Reserve Board.

LIMITATIONS ON SCOPE OF ACTIVITIES

Business in United States.—"No corporation organized under this section shall carry on any part of its business in the United States except such as, in the judgment of the Federal Reserve Board, shall be incidental to its international or foreign business: AND PROVIDED FURTHER, That except such as is incidental and preliminary to its organization no such corporation shall exercise any of the powers conferred by this section until it has been duly authorized by the Federal Reserve Board to commence business as a corporation organized under the provisions of this section.

PRICE FIXING

"No corporation organized under this section shall engage in commerce or trade in commodities except as specifically provided in this section, nor shall it either directly or indirectly control or fix or attempt to control or fix the price of any such commodities. The charter of any corporation violating this provision shall be subject to forfeiture in the manner hereinafter provided in this section. It shall be unlawful for any director, officer, agent, or employee of any such corporation to use or to conspire to use the credit, the funds, or the power of the corporation to fix or control the price of any such com-

modities, and any such person violating this provision shall be liable to a fine of not less than $1,000 and not exceeding $5,000 or imprisonment for not less than one year and not exceeding five years, or both, in the discretion of the court.

CAPITAL STOCK AND DIVIDENDS

$2,000,000 minimum; investments by banks.—"No corporation shall be organized under the provisions of this section with a capital stock of less than $2,000,000, one-quarter of which must be paid in before the corporation may be authorized to begin business, and the remainder of the capital stock of such corporation shall be paid in installments of at least 10 per centum on the whole amount to which the corporation shall be limited as frequently as one installment at the end of each succeeding two months from the time of the commencement of its business operations, until the whole of the capital stock shall be paid in. The capital stock of any such corporation may be increased at any time, with the approval of the Federal Reserve Board, by a vote of two-thirds of its shareholders or by unanimous consent in writing of the shareholders without a meeting and without a formal vote, but any such increase of capital shall be fully paid in within ninety days after such approval; and may be reduced in like manner, provided that in no event shall it be less than $2,000,000. No corporation, except as herein provided, shall during the time it shall continue its operations, withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital.

Purchase of stock.—"Any national banking association may invest in the stock of any corporation organized under the provisions of this section, but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus.

AMERICAN OWNERSHIP

Directors, officers, etc.—"A majority of the shares of the capital stock of any such corporation shall at all times be held and owned by citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States, chartered under

the laws of the United States or of a State of the United States, or by firms or companies, the controlling interest in which is owned by citizens of the United States. The provisions of section 8 of the Act approved October 15, 1914, entitled 'An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,' as amended by the Acts of May 15, 1916, and September 7, 1916, shall be construed to apply to the directors, other officers, agents, or employees of corportaions organized under the provisions of this section: PROVIDED, HOWEVER, That nothing herein contained shall (1) prohibit any director or other officer, agent or employee of any member bank, who has procured the approval of the Federal Reserve Board from serving at the same time as a director or other officer, agent or employee of any corporation organized under the provisions of this section in whose capital stock such member bank shall have invested; or (2) prohibit any director or other officer, agent, or employee of any corporation organized under the provisions of this section, who has procured the approval of the Federal Reserve Board, from serving at the same time as a director or other officer, agent or employee of any other corporation in whose capital stock such first mentioned corporation shall have invested under the provisions of this section.

DIRECTORS

Reserve Board members.—"No member of the Federal Reserve Board shall be an officer or director of any corporation organized under the provisions of this section, or of any corporation engaged in a similar business organized under the laws of any State, nor hold stock in any such corporation, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement.

DISSOLUTION

LIABILITY OF STOCKHOLDERS, OFFICERS AND DIRECTORS

"Shareholders in any corporation organized under the provisions of this section shall be liable for the amount of their unpaid stock subscriptions. No such corporation shall become a member of any Federal Reserve bank.

FORFEITURE OF FRANCHISE

Violation of law.—"Should any corporation organized hereunder violate or fail to comply with any of the provisions of this section, all of its rights, privileges, and franchises derived herefrom may thereby be forfeited. Before any such corporation shall be declared dissolved, or its rights, privileges, and franchises forfeited, any noncompliance with, or violation of such laws shall, however, be determined and adjudged by a court of the United States of competent jurisdiction, in a suit brought for that purpose in the district or territory in which the home office of such corporation is located, which suit shall be brought by the United States at the instance of the Federal Reserve Board or the Attorney General. Upon adjudication of such noncompliance or violation, each director and officer who participated in, or assented to, the illegal act or acts, shall be liable in his personal or individual capacity for all damages which the said corporation shall have sustained in consequence thereof. No dissolution shall take away or impair any remedy against the corporation, its stockholders, or officers for any liability or penalty previously incurred.

Voluntary liquidation.—"Any such corporation may go into voluntary liquidation and be closed by a vote of its shareholders owning two-thirds of its stock.

INSOLVENCY AND RECEIVERSHIP

"Whenever the Federal Reserve Board shall become satisfied of the insolvency of any such corporation, it may appoint a receiver who shall take possession of all of the property and assets of the corporation and exercise the same rights, privileges, powers, and authority with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller of the Currency of the United States: PROVIDED, HOWEVER, That the assets of the corporation subject to the laws of other countries or jurisdictions shall be dealt with in accordance with the terms of such laws.

FINANCES

Annual meetings; reports and examinations.—"Every corporation organized under the provisions of this section shall hold a meeting of

its stockholders annually upon a date fixed in its by-laws, such meeting to be held at its home office in the United States. Every such corporation shall keep at its home office books containing the names of all stockholders thereof, and the names and addresses of the members of its board of directors, together with copies of all reports made by it to the Federal Reserve Board. Every such corporation shall make reports to the Federal Reserve Board at such times and in such forms as it may require; and shall be subject to examination once a year and at such other times as may be deemed necessary by the Federal Reserve Board by examiners appointed by the Federal Reserve Board, the cost of such examinations, including the compensation of the examiners, to be fixed by the Federal Reserve Board and to be paid by the corporation examined.

Dividends.—"The directors of any corporation organized under the provisions of this section may, semiannually, declare a dividend of so much of the net profits of the corporation as they shall judge expedient; but each corporation shall, before the declaration of a dividend, carry one-tenth of its net profits of the preceding half year to its surplus fund until the same shall amount to 20 per centum of its capital stock.

TAXATION

State Taxation.—"Any corporation organized under the provisions of this section shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations.

RENEWAL

Twenty-year period.—"Any corporation organized under the provisions of this section may at any time within the two years next previous to the date of the expiration of its corporate existence, by a vote of the shareholders owning two-thirds of its stock, apply to the Federal Reserve Board for its approval to extend the period of its

corporate existence for a term of not more than twenty years, and upon certified approval of the Federal Reserve Board such corporation shall have its corporate existence for such extended period unless sooner dissolved by the act of the shareholders owning two-thirds of its stock, or by an act of Congress or unless its franchise becomes forfeited by some violation of law.

CONVERSION

Conversion of State institutions; State law.—"Any bank or banking institution principally engaged in foreign business incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a corporation under the provisions of this section may, by the vote of the shareholders owning not less than two-thirds of the capital stock of such bank or banking association, with the approval of the Federal Reserve Board, be converted into a Federal corporation of the kind authorized by this section with any name approved by the Federal Reserve Board: PROVIDED, HOWEVER, That said conversion shall not be in contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of at least two-thirds of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a Federal Corporation. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a Federal corporation. The shares of any such corporation may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the corporation until others are elected or appointed in accordance with the provisions of this section. When the Federal Reserve Board has given to such corporation a certificate that the provisions of this section have been compiled with, such corporation and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by this section for corporations originally organized hereunder.

EMBEZZLEMENT—PENALTIES

False entries; penalties for abuses.—"Every officer, director, clerk, employee, or agent of any corporation organized under this section who embezzles, abstracts, or wilfully misapplies any of the moneys, funds, credits, securities, evidences of indebtedness or assets of any character of such corporation; or who, without authority from the directors, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, debenture, draft, bill of exchange, mortgage, judgment, or decree; or who makes any false entry in any book, report, or statement of such corporation with intent, in either case, to injure or defraud such corporation or any other company, body politic or corporate, or any individual person, or to deceive any officer of such corporation, the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of any such corporation; and every receiver of any such corporation, and every clerk or employee of such receiver who shall embezzle, abstract, or willfully misapply or wrongfully convert to his own use any moneys, funds, credits, or asests of any character which may come into his possession or under his control in the execution of his trust on the performance of the duties of his employment; and every such receiver or clerk or employee of such receiver who shall, with intent to injure or defraud any person, body politic or corporate, or to deceive or mislead the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such receiver, shall make any false entry in any book, report, or record of any matter connected with the duties of such receiver; and every person who with like intent aids or abets any officer, director, clerk, employee, or agent of any corporation organized under this section, or receiver or clerk or employee of such receiver as aforesaid in any violation of this section, shall upon conviction thereof be imprisoned for not less than two years nor more than ten years, and may also be fined not more than $5,000, in the discretion of the court.

FALSE REPRESENTATION

"Whoever being connected in any capacity with any corporation organized under this section represents in any way that the United States is liable for the payment of any bond or other obligation, or the

interest thereon, issued or incurred by any corporation organized hereunder, or that the United States incurs any liability in respect of any act or omission of the corporation, shall be punished by a fine of not more than $10,000 and by imprisonment for not more than five years."